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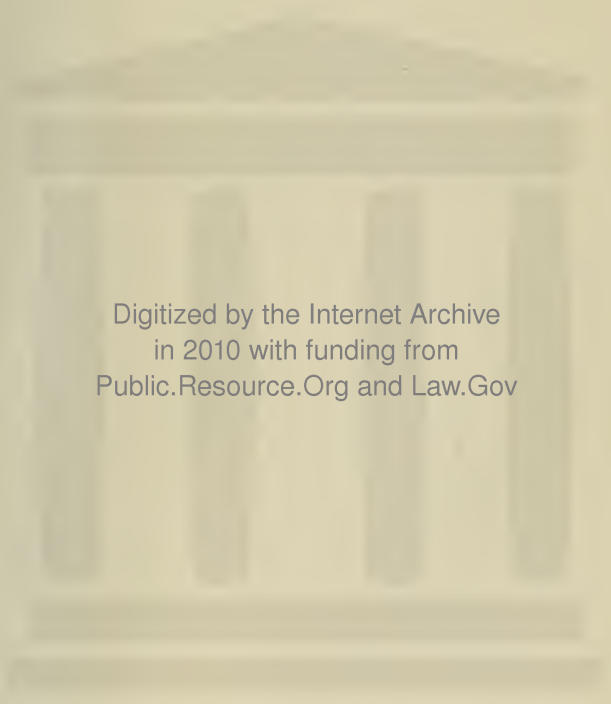
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No. 15726 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT J. FIHE, ELIZABETH M. FIHE, Husband and
Wife,

Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

APPELLANTS' OPENING BRIEF.

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FILED

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PAUL E. DORRIS, Secy.

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APPELLANTS' OPENING BRIEF.

I.

STATEMENT OF THE CASE.

This appeal comprises a petition to review a decision of the Tax Court of the United States.

One of the disputed questions before the Tax Court was whether or not a true partnership existed between the two Petitioners during the greater part of the year 1946. Petitioners filed separate returns and paid their individual taxes as members of the partnership for the year 1946. The Internal Revenue Agent contended that there was not a true partnership, but after the trial, the Director of Internal Revenue conceded this point and submitted revised computations.

Accordingly, the remaining questions now before this Court relate specifically to improperly imposed penalties, unwarranted disallowances of deductions by the taxpayers, arbitrary assessments against the taxpayers and improper and very peculiar bookkeeping methods employed by the successors of the partnership, which showed income never received by the Petitioners.

II.

ABSTRACT OF THE FACTS.

Petitioner Albert J. Fihe is a practicing lawyer, specializing in patents and trademarks, having opened an office in Chicago in 1922 [R. 48]. Now operating in Burbank [R. 213].

In the year 1936, Albert obtained a patent on a hamburger patty molding machine for Harry Holly of Chicago [R. 171]. The invention appeared to have some merit and the Fihes (Albert and Elizabeth) financed Holly in the manufacture and distribution of these machines through eight or nine very lean years, contributing about eight or nine thousand dollars annually [R. 172]. The greater part of this money was contributed by Elizabeth.

Up to January of 1945, the partnership consisted of the inventor Holly and Albert Fihe. At that time a four party partnership was organized which included the wives of the two original partners, Elizabeth having insisted that she have a vested interest because of her cash investments and considerable work in the business [R. 172, 176]. In the years 1945 and 1946, the business

finally began to show a profit, and on September 25, 1946, an Illinois Corporation known as Holly Molding Devices, Inc. was organized, each of the four partners receiving fifty shares namely, one-fourth of the stock [R. 170 and 207].

Sometime in the spring of 1946, while Petitioner Albert was away on a business trip, Harry Holly, together with an internal revenue agent and the company's auditor, conspired to defraud the Government out of approximately \$3,000.00 in income taxes [R. 204], upon condition that the agent would receive \$1,000.00 in cash and the auditor \$500.00, which money was to be contributed by Holly and Fihe.

Fihe, upon returning from the trip, was advised of the proposed arrangement but refused to have any part of it [R. 205].

Holly insisted upon proceeding, whereupon Albert reported the whole matter to the Internal Revenue Agent in Chicago, who called in the Federal Bureau of Investigation. These people furnished Albert with some marked money to give the Agent, which he did, much against his will, and only after considerable pressure by the F. B. I. and their insistence that he perform his duty as an honest citizen [R. 206]. Holly, the auditor and the agent were all convicted and served terms in federal penitentiaries.

As a result of consequent ill feeling, Albert and Elizabeth sold their stock in the Corporation for \$100,000.00 and moved to California in 1948.

Also, as a result, your Petitioners have, ever since that date, been the object of a great deal of investigation, and what might actually be termed persecution, by internal revenue agents, both in Chicago and Los Angeles. A great deal of this activity comprised continued expressions of disbelief of the taxpayers returns, persistent requests for attendance at investigative hearings, one of which required the presence for an entire week by Albert in the offices of the Collector of Internal Revenue in Chicago [R. 208].

Another result was the reconstruction in the year 1948 of the Holly corporate books by a firm of certified public accountants. These people, without the knowledge of the Fihs, completely revised the 1947 financial statements of the Corporation and included many debits against the personal accounts of both Albert and Elizabeth varying in amount from \$20.00 to \$10,000.00, practically all of which were entirely unwarranted and with no foundation whatever, as shown by the record. Petitioners deeply resent being taxed on these false and fictitious records, which show income they did not receive.

These facts comprise the main reasons for this appeal; namely persecution and penalizing of honest citizens by the Director of Internal Revenue because of having reported his crooked agents. Furthermore, Harry Holly, having served a term in the penitentiary, because of Fihe, apparently instigated the manipulation of the corporate books in the hope of revenge.

III.

SPECIFICATION OF ERRORS.

Heretofore, Petitioners have specified, for the transcript, a summary of the errors which they urge [R. 76], as follows:

1. The Honorable Judge of the Tax Court erred in holding that Petitioners understated their business income for the years 1947 to 1949, inclusive, and the Court erred in not allowing itemized and proper deductions in each of said years.

2. The Honorable Judge erred in holding that Petitioners understated income derived from the corporation known as Holly Molding Devices, Inc., of Chicago, Illinois, for the years 1947 and 1948. Petitioners assert that the corporate records were deliberately changed and falsified after Petitioners sold their interests and stock in the company.

3. The Tax Court erred in taking into consideration the fact that the then president of Holly Molding Devices, Inc., namely Harry H. Holly, was an ex-convict, having served a term in the federal penitentiary for attempted income tax evasion and also for actual bribing of an internal revenue agent. The statements and records of such a person should not be given precedence or preference over the word of a reputable attorney, sworn to uphold the Constitution, especially as he had actually reported Holly's wrongdoings to the Federal Bureau of Investigation and the Internal Revenue Department.

4. The Judge of the Tax Court erred in holding that the Petitioners did not invest at least \$35,000.00 to \$50,000.00 in the corporation's predecessor partnership known as Holly Molding Devices during the ten years of 1936 to 1945, inclusive, and in ruling that the Petitioners realized a long term capital gain of about \$80,000.00 when selling their stock in the corporation in 1948. Petitioners' profit was not over \$50,000.00, and was distributed over several years.

5. The Judge erred in assessing a negligence penalty against the Petitioners for each of the years 1946, 1947 and 1948, regardless of the fact that Petitioners at the trial submitted books of record showing careful and individual entries for all their business transactions for the years 1947, 1948 and 1949, which corresponded with their returns for those years.

6. The Tax Court erred in ruling that the non-negotiable notes which Petitioners received when selling their stock in the corporation represented actual cash and taxed Petitioners accordingly. Payments on these notes extended over a period of more than three years, and taxes should accordingly have been so distributed. The Court erred in taxing the Petitioners on the entire sum in the year 1948, although payments were never assured and could not have been collected by Petitioners under any circumstances in the one year of 1948.

7. The Court erred in determining a tax deficiency against the Petitioners of approximately \$7,000.00 for the year 1948, when, in fact, Petitioners experienced and reported a business loss of over \$20,000.00 in the year 1950, which should be applied as a carry-back to the year 1948. Petitioners' profits for 1948 were not substantial in any event.

8. The Judge erred in not recognizing the proven fact that Petitioners saved the United States Government untold sums of money in reporting the wrongdoings and fraudulent actions of Harry H. Holly, his company auditor and the Internal Revenue Agent conspiring with them. The honesty and integrity of the Petitioners have been proven to be above reproach and any reasonable doubt should be resolved in Petitioners favor.

The foregoing specification of errors will be fully developed in the argument section.

IV.

PROCEEDINGS BEFORE THE LOWER COURT.

A great deal of the trial proceedings related to proof by the Petitioners that a true partnership existed, so far as Albert and Elizabeth were concerned. This was important, because the Commissioner of Internal Revenue had, under date of January 14, 1954 [R. 7] advised Petitioner Albert that he would not recognize the partnership status and accordingly transferred an amount of \$13,663.34 from income reported by Elizabeth for the year 1946 to Albert's account, rendering a deficiency of income tax in the amount of \$9,515.06. He also arbitrarily added a 5% negligence penalty of \$475.75.

After incontrovertible proof at the trial, the Commissioner conceded that a true partnership existed. Accordingly a great deal of the evidence adduced at the trial need not now be considered.

V.

ARGUMENT.

A. Facts and Law.

The remaining questions before this Honorable Court are almost all strictly factual, and there is no point in citing many legal decisions, because they would have little bearing on the situation.

So far as the actual questions are concerned they can be stated as follows:

B. The Year 1946.

A revised computation of tax against Albert and Elizabeth Fihe for the year 1946 is now set up by the Commissioner as follows: Albert J. Fihe, 1946 Deficiency \$2,826.87—negligence penalty \$141.34 [R. 34]. Elizabeth M. Fihe, 1946 Deficiency \$2,687.00—negligence penalty \$141.34 [R. 35].

It will be noted that Petitioners each paid a tax for the year 1946 in the amount of \$1,463.08 [Resp. Ex. C] and the additional sum of \$2,826.87 is contended by the Commissioner to be a deficiency. This is unreasonable and not substantiated. Petitioners however, have tentatively agreed to an additional tax of \$826.87 each [R. 40], and have indicated their willingness to pay this. However, as the 1946 returns were prepared by a firm of certified public accountants [see Resp. Exs. H and I] any penalty for negligence is absolutely and wholly unwarranted. These unreasonable penalties comprise one of the reasons for this appeal.

C. The Year 1947.

The Commissioner of Internal Revenue disagreed considerably with the Petitioners joint return for the year 1947 and decided that they had an additional income for that year of \$27,306.48 [R. 21]. Petitioners disagree with this in every respect, but inasmuch as there is a carry-back allowance from losses sustained in the year 1949, with a resultant deficiency assessment of only \$397.40, Petitioners have tentatively agreed to pay this, inasmuch as it is hardly worth this Court's time or that of anyone else. However, Petitioners emphatically dispute the 5% penalty of \$533.78 arbitrarily assessed by the Commissioner and acquiesced in by the Tax Court. In this case, as in the year 1946, the Petitioners returns reflected absolute concurrence with the Corporation income tax return for the year 1947 [Resp. Ex. J]. This return was prepared by a firm of certified public accountants and there is no reason why Petitioners should be penalized in any respect for such a return.

D. The Year 1948.

In this year lies the main "bone of contention."

First, Petitioners sustained a considerable loss in the year 1950, which, if properly computed as a carry-back, would eliminate any tax for this year [R. 213].

Second, the Commissioner of Internal Revenue and also the Tax Court both gave great credence to the bookkeeping methods employed by the corporation during that year, wherein considerable sums were charged to the Petitioners' accounts, with absolutely no basis whatever.

For example, in the deposition of Respondent's witness Wiscons there was shown a charge against the account of Albert Fihe in the amount of \$11,920.00.

Upon being asked on cross-examination, as to the origin of that charge, the witness said "I do not know that. I do not know." [R. 138]. He also admitted that this was a pencil notation.

Upon further cross-examination, the following transpired [R. 153]:

"Q. (By Mr. Fihe): Your accountants made the entries, did they not? A. Not the payroll entries.

Q. No, I mean that last thing—this \$11,000 in the ledger? A. The accountants had, I believe, given us the entries to make.

Q. And they are just in pencil at the bottom of that page? A. On this one here (indicating).

Mr. Levin: Let us identify the book.

Mr. Fihe: I am talking about my own page with my name at the top showing payroll checks.

The Witness: That is my writing.

Q. (By Mr. Fihe): It is in pencil? A. Yes.

Q. Who told you to do that? A. It was set up from the general ledger book to the payroll book.

Q. Who told you to do that? A. I would assume the accountants at that time. No one else knew anything about it, outside of yourself and Mr. Bornstein.*

Q. Who was the accountant? A. Barrow, Wade & Guthrie.

Q. You mentioned Mr. Bornstein. He was your auditor in 1946 and early 1947, was he not? A. If you can call him an auditor. He used to come in and check the books. I do not know.

*Bornstein was the company auditor who conspired with Holly and the Internal Revenue Agent to defraud the Government.

Q. Don't you know he went to the penitentiary for attempted income tax evasion?

Mr. Levin: I object on the ground that the question is immaterial and irrelevant.

The Witness: I believe I heard of it."

Fihe personally testified that he never received such a sum [R. 224-236]. There were many other charges against the accounts of Albert and Elizabeth Fihe made in the year 1947, which this witness could not explain [R. 143, 145, 149, 150, 151].

Wiscons testified that as of October 1, 1946, the books showed liabilities from the corporation to Petitioner A. J. Fihe in the amount of \$4,661.49 and to Petitioner E. M. Fihe in the amount of \$3,461.29 [R. 85]. Both Mr. and Mrs. Fihe testified, under oath, in Court that they never received that money [R. 167, 211].

As stated by A. J. Fihe, in his testimony, someone in the Holly organization, or their accountants or auditors, took it upon themselves to completely revamp the books which were kept by Petitioner up to the end of 1947. These changes showed quite a bit of money either charged to the Fihes' account or showing money that was presumably paid to them and which they did not get [R. 211].

This is borne out by the very vague and wholly unsubstantiated testimony of Wiscons (Respondent's own witness) who repeatedly stated with regard to amounts charged to the Fihes that there was no explanation therefor. Here the witness said "I am afraid I cannot answer that. I don't know just how these things were set up at that time. There are some entries here which credit Mr. Fihe on journal entries and there are also some journal entries that charged the personal account." [R. 89, 222.]

Again [R. 90]:

“Q. Is there an explanation as to that amount?

A. Let's see. No sir, all there is is a check made out November 1 for \$500.00 to Mr. Albert J. Fihe and a check on November 25, 1946 made payable to Mr. Albert J. Fihe for \$2,000.00. * * * There is an entry in our general ledger as of January 31, debiting Mr. Albert J. Fihe for \$1,000.00.

Q. Is there any explanation as to that amount?

A. No sir. There is just a check issued on January 10 in the amount of \$1,000.00 and charged to the account of Albert J. Fihe. * * * March 31 there was a debit of \$800.00 to the account of Mr. Albert J. Fihe.

Q. Is there any explanation for that amount?

A. No, there isn't.”

On page 97 of the Transcript the following appeared:

“A. April 30, 1947: We have two entries in our general ledger to the account of Mr. Albert J. Fihe; one in the amount of \$3,725.00 and the other in the amount of \$3,000.00 even.

Q. Are there any explanations for these amounts?

A. The one for \$3,000.00 has an explanation. It was written to Mr. A. J. Fihe, and the explanation is ‘loan from corporation’.”

As testified by both the Fihees in Court, the corporation never lent either of the Fihees any money. It was the other way around [R. 172, 211, 243].

There was another item marked “loan from corporation” in the amount of \$2,600.00. As Fihe explained [R. 58] this was for legal fees paid for the defense of H. H. Holly in the criminal suit against him wherein he was convicted of bribing an Internal Revenue Agent.

Again [R. 92]:

“The other amount of \$3,725.00 was issued in the form of three checks, two of them in the amount of \$700.00 each, and one in the amount of \$2,325.00 even.

Q. Do those contain any explanation? A. Those last three, no, sir.”

The Fihs testified that they had never borrowed from the company but that they continually advanced considerable funds to keep the company going [R. 156, 171].

The Witness Wiscons also mentioned many other items presently appearing on the books of Hollymatic Corporation and which were dated back to the time that Petitioners were active in the business of its predecessors. For example [R. 90] there is a debit on the books dated November 30, 1946, to the account of Albert J. Fihe in the amount of \$2,500.00 with no explanation, a debit of \$1,000.00, no explanation, also in the same page a debit of \$800.00 with no explanation [R. 91].

On page 95 of the Transcript there is shown a lot of entries, mostly charges against the Petitioners, the only explanation being “to transfer advances to officers to proper accounts.” As the Petitioners testified, there were no advances to officers at any time. There was some division of profits to the partners, there was some rent collected by the four partners on real estate owned by the partnership, there were salaries paid and there were some repayments of loans, but never any advances [R. 211].

The witness testified regarding some entries [R. 97], one of which is a debit to the account of Albert J. Fihe for patents. If anything, this should have been a credit for patent work which was freely given the corporation

and no monetary charge was made at any time, all as substantiated by the evidence in Court [R. 248].

The amount of \$3,632.05 stated by Wiscons to have been paid to A. J. Fihe on June 25, 1947, is actually about the only correct amount listed in all his depositions. This was a partial payment on a loan and was properly credited on the notes given Albert J. Fihe by the original partnership [Pet. Ex. 10]. On September 30, 1947 [R. 101], there was a charge to A. J. Fihe in the amount of \$5,-890.00. As explained in Court, this was a check given Fihe for his office furniture which he sold to the corporation and upon which the corporation later reneged. The actual payment was explained by Fihe [R. 201]. It is noted that the reporter stated the amount as \$8,090.67 but Petitioners' Exhibit 12, which is the actual bill of sale and is in evidence here, shows that the amount was only \$890.67. Fihe lost \$5,000.00 on this transaction alone [R. 167].

Also, on page 149, the following occurs:

"Q. (By Mr. Fihe): I believe you testified that your records showed I was paid three weeks salary in the beginning of 1948 at \$400 a week, amounting to \$1,200. Then you went on to testify that your records showed there was a further charge against me of \$981.90; and it was charged for salary. Can you explain how—when I resigned as president of the corporation as of the first three weeks of 1948—I drew any more salary after that, having completely severed my connection with the corporation? A. I do not know how you could have drawn any more."

Fihe himself testified in Court that the books were not in their present condition when he had charge of them, and further stated that the accountants, Barrow, Wade & Guthrie, performed some really unusual feats of book-keeping [R. 222; Resp. Exs. K and L].

Also, the Commissioner and the Court would not agree that the Fihe invested any more than approximately a total of \$20,000.00 in the partnership business over a period of almost ten years, while the uncontradicted sworn testimony of both the Petitioners in Court shows that the combination of loans, investments and other advances was much greater, namely around \$45,000.00 or \$50,000.00 [R. 193].

Obviously, if the Fihe received \$100,000.00 for their half of the business, the entire business was worth \$200,000.00. It is beyond the realms of possibility that a \$200,000.00 business could be built up from an initial investment of only \$20,000.00 (the Commissioner's figure), especially when the first ten years of the business constituted a continuously losing operation [R. 159].

As an alternative and possibly a very accurate estimate of the contributions to the partnership by the Fihe over the years, it will be noted that the total assets at the time that the corporation was organized amounted to \$32,698.28. Finding of Fact [R. 67].

It being obvious that neither one of the Holly's had, at any time, any money to invest, this sum of \$32,698.08 is a very fair representation of the amount contributed

by the Fihs, and is respectfully requested that this Court consider this as a basis for figuring the long term gain on the final selling price of the stock owned by the Fihs. This would leave a long term gain of \$67,301.72.

Another question regarding this long term gain is whether it should all be computed in the one year of 1948 or spread over two or three of the succeeding years as the Petitioners contend.

It happened that the Petitioners did, through the years 1949 through 1951, erroneously report this long term gain as income, but inasmuch as they lost money in each of those years there was no tax in any event [R. 213].

Petitioners still insist that inasmuch as the notes which they received in part payment of their stock were not negotiable, the entire profit cannot properly be taxed against them for the year 1948. Of the approximate \$100,000.00 received by Petitioners when selling out, \$25,000.00 was received in cash, \$5,000.00 was arbitrarily charged to the account of A. J. Fihe but never paid to him [R. 125, 201] and the remainder of \$70,000.00 was in the form of notes, payable to the individual Petitioners, totaling \$1,750.00 monthly for forty months, plus interest. These notes were written so as to specifically exclude the words "OR ORDER" [R. 225] from each, making them non-transferable and non-negotiable. Fihe testified that the notes themselves had no actual value, regardless of the chattel mortgage, because the chattel mortgage itself was worthless [R. 243]. Inasmuch as the notes were not negotiable and that the Fihs could not have at any time realized any money from them or even sold them to anyone, the transaction was, therefore, not completed in the year 1948, but was a continuing matter until the last note was paid in 1951.

Such non-negotiable notes have always been considered by the Courts as having no fair market value. (See *Humphrey*, 32 B. T. A. 280, also *Mary T. Smith*, 4 T. C. Memo. 440.)

Even assuming that the Commissioner and the Court were correct in holding that the entire long term capital gain should be assessed in one year, the following computation based on an original investment of \$32,698.28 should apply.

Computation of tax for 1948, considering all disallowances but figuring long term capital gain on amount actually received in that year from sale of corporate stock.

Admitted net business loss as shown	
by agent's report	\$ 6,698.08
Less exemptions (add)	1,800.00
	<hr/>
Joint income subject to tax (loss)	\$ 8,498.08
½ long term capital gain	\$41,500.00
Less original investment as	
recognized by Court [R.	
25]	20,595.37
	<hr/>
	\$20,904.63
Net income	12,406.55
\$68.00 + 12% of excess over \$400.00	1,508.72
Less withholding taxes paid on salary	206.70
	<hr/>
Total Joint Tax for 1948	\$1,302.02

Another manner of computing would be to consider the original Fihe investment as only \$20,595.37 [R. 25], which then produced a long term capital gain of \$79,-

404.63; but recognizing the fact that the disallowances by the Commissioner were improper, the following will apply.

Disallowances eliminated:

Interest	\$ 235.40
Tax	511.29
Damage and Theft Losses	3,362.44
Legal Expense	561.75
Freight	1,124.45
Stationery	150.00
Travel Expenses	5,802.97
Commissions	800.00
Advertising	598.14
Repairs	74.57
Postage	243.33
Telephone and Telegraph	71.53
Depreciation	1,986.58
Contributions	373.23

Total	<u>\$15,895.68</u>
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Net loss as shown by return	\$22,593.76
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Less exemptions (add)	<u>1,800.00</u>
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Joint income subject to tax (loss)	\$24,393.76
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½ long term capital gain	<u>39,702.35</u>
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Net income	<u>\$15,309.39</u>
------------	--------------------

Tax computation:

\$68.00 + 12% of excess over

\$400.00	\$1,857.08
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Less withholding	206.70
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Joint tax for 1948	<u>\$1,651.38</u>
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It will be noted that either method of computing the tax results in an amount much less than that arrived at by the Commissioner and concurred in by the Court.

Furthermore, if a more reasonable application of original investment is made, namely the sum of approximately \$32,700.00 [R. 67] as against approximately \$20,000.00, the tax on the joint return for 1948 would, in either case be only about one-half of that computed above.

It is again respectfully pointed out that if a carry-back loss from the year 1950 be applied, there would be no tax whatever against the Petitioners for the year 1948.

Albert commented briefly regarding some of the very unfair disallowances made by various agents when checking his returns. For example, a deduction of \$92.00 for contributions in the year 1947 was completely disallowed by the Agent [R. 210]. An item of \$19.00 for medical expense was disallowed [R. 209]. Such actions were indicative of the antagonistic, belligerent and entirely unreasonable attitude of one or more of the agents or their superiors. For the year 1948, contributions were disallowed in the amount of \$373.23, traveling expense in the amount of \$5,800.00 was disallowed, advertising in the amount of \$598.00 was disallowed. Depreciation in the amount of \$1,986.58 was disallowed [R. 50]. As Fihe explained, he had, upon moving to California, bought a small factory and some used machinery, upon which extensive repairs were necessary and a considerable amount of depreciation was taken on both the real estate and the machinery, which it is believed is very reasonable under the circumstances [R. 213].

Fihe, in his testimony, commented upon the disallowance of a loss claimed for damages to his household furniture when he moved from Illinois to California in the year 1948. This was claimed as \$3,362.44 and both witnesses testified fully regarding the same, none of which has ever been recovered [R. 212]. The disallowance of this entire amount was wholly uncalled for. Freight charges for moving both household and office furniture to California was also disallowed *in toto*. Traveling expense in the amount of \$5,802.97 was disallowed completely, although all of it was for business purposes, as also the item of \$800.00 for commissions. The total deductions disallowed for the year 1948 was \$15,522.45 [R. 50], which, as Fihe testified, was most peculiar in that he had arrived at what he thought was a reasonable adjustment of these items following work with the Agents in Chicago for an entire week. Fihe traveled from California to Chicago for that purpose alone and paid all expenses and gave freely of his time for the period. Regardless of this and the oral agreements, the written report completely reversed practically all of the agreed upon matters for all four years [R. 208].

E. The Year 1949.

As Fihe also testified with regard to the year 1949, deductions in the amount of over \$10,000.00 were disallowed as either personal items or duplications, although originally allowed in the conferences in Chicago. Fihe testified that all these deductions were proper and fully accounted for [R. 212-213].

Also, relative to the year 1949, Fihe testified [R. 214]:

“I spent a terrific amount on advertising in the year 1949, trying to promote the sale of that fishing reel. The agent disallowed \$2,000.00 of it.

“I did a lot of traveling; the agent disallowed \$1,900.00 of traveling expenses. He disallowed interest which I had paid on loans in the amount of \$600.00. The agent disallowed postage in the amount of \$249.00. How can a business operate without spending money for postage and that is only \$20.00 a month, which I think is very reasonable.”

Travel expense in the amount of \$1,983.17 was disallowed for 1949. The Tax Court should have taken judicial notice of the fact that a patent lawyer, such as the Petitioner here, must inevitably travel a great deal and certainly more than other lawyers; and as Petitioner Fihe himself testified, practically all of the entire amounts disallowed were verified by vouchers, cancelled checks or other records made at the time [R. 214].

Medical expenses in all the years in question were practically wholly disallowed, although proper proof of same was submitted. In fact, the amount claimed for medical expenses in the year 1949 was \$1,089.34 and the Agent quite arbitrarily disallowed the entire sum [R. 212]. Petitioners, with not only their own status in mind, but also that of other taxpayers, cannot in good conscience permit such complete and outrageous disregard of their constitutional rights.

Our United States Supreme Court has said that “Anyone may so arrange his affairs that his taxes shall be as low as possible. He is not bound to choose the pattern which would best pay the Treasury. It is not even a patriotic duty to increase one’s taxes.” (*Bullen v. Wisconsin*, 240 U. S. 625-630.)

F. Penalties.

The Agents arbitrarily affixed negligence penalties. As explained by Albert, and as brought out in his cross-examination, complete books and records were kept by the Petitioners at all times and were always available for inspection by Respondent's Agents. Fihe explained that he had spent a solid week in the Internal Revenue Offices in Chicago in an effort to arrive at a reasonable conclusion of the alleged differences for the period in question here [R. 209]. It was further explained that the account book kept by the Petitioners, together with all the other records, including cancelled checks, and which were brought into Court at the trial, had been available to the Agents in Chicago and Los Angeles at any time that they requested. The account book was described in detail [R. 208 and 234]. Certified Public Accountants prepared the 1946, 1947 and 1948 returns [Resp. Exs. H, I and J].

Fihe testified that Agents from both Chicago and Los Angeles had inspected that book and all the other records produced at the trial. Also, as will be evident from the returns, the Petitioners operated on a cash and not an accrual basis and kept very simple check book records of receipts and disbursements, together with a careful distribution of those items. An annual summary of same, with substantiating records, obviously suffices for any purpose, audit or otherwise. There was no negligence and there should be no penalty.

Fihe further stated [R. 208] "There are some penalties assessed against both Mrs. Fihe and me for negligence in keeping our books. In our protest, we naturally disagree with those penalties. We believe that we kept our books in good shape. In fact, I have here a record of

all of our transactions during those years and I believe that Mr. Propeck, the agent here, has gone through that book very carefully. Well, somebody from this office has indicated negligence but I know that somebody from the Commissioner's office has been through that book. I am positive of that because he came out to my office at Burbank and stayed there for two days. I don't remember whether it was this gentleman or not."

Also [R. 214]: Frankly, in summing up, your Honor, I am convinced in my own mind that we paid our taxes, try to do my duty as an honest citizen. I think the record will show that I have done so, and frankly I have gone about my duty in reporting what happened.

G. Conclusion.

This Court's own decisions substantiate Petitioners' contention that the notes received when they sold their interest were not negotiable, and that therefore, the proceeds thereof cannot be taxed all in the year 1948 but should be distributed up to and including the year 1951; also as capital gains, not income.

The evidence also proves that Petitioners were more than reasonable in their claim of an original investment of \$35,000.00 for which they received \$100,000.00 when selling. The testimony indicates that the original investment was more nearly \$50,000.00 [R. 172].

The tax returns submitted by the successor of the original partnership appear to be an attempt to render the Petitioners liable for taxes on almost double the sums which they actually received and to save some taxes themselves [Exs. H to M, incl.].

The disallowances by various agents of practically all of the deductions claimed by Petitioners over the years

involved were unfair and actually ridiculous in many instances. Petitioners submitted proper returns, paid their taxes, did more than their duty as honest citizens in reporting the conspiracy to defraud the Government, and should be praised, rather than censured and punished.

The Commissioner and the Internal Revenue Agents insisted, to the bitter end, that no true partnership existed between the Petitioners here. After conclusive proof in Court, they meekly conceded that important point. They still insist on unwarranted disallowances of proper deductions and insist upon assessing terrific penalties, alleging negligence. As here pointed out, the Tax Court should not have upheld these unreasonable disallowances and penalties. Apparently, the Tax Court believed the testimony of an employee of an ex-convict and put considerable faith in the records of a corporation, of which this ex-convict is the President.

The testimony, in open Court, of the Petitioners, who have proved themselves honest and upright, and who actually caused the conviction of Holly and those who conspired with him to defraud the Government, should certainly have more weight with any tribunal.

The fact that these Petitioners did much more over and above their line of patriotic duty in reporting these conspirators, should be carefully considered by this Honorable Court in deciding the issues here presented.

May 7, 1958.

Respectfully submitted,

ALBERT J. FIHE,

Attorney for Petitioners-Appellants.

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No. 15726

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT J. FIHE, ELIZABETH M. FIHE, Husband and
Wife,

Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

APPELLANTS' REPLY BRIEF.

FILED

JUN 19 1958

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Respondent-Appellee.

APPELLANTS' REPLY BRIEF.

*To the Honorable Judges of the United States Circuit
Court of Appeals for the Ninth Circuit:*

There are some glaring discrepancies and at least one actual misstatement of fact in Respondent's brief which cannot go unchallenged.

Unfettered Control of Funds.

On pages 12, 27 and 42, of typewritten brief, Counsel for Respondent states that Petitioners Albert J. and Elizabeth Fihe had "unfettered" control of the funds of the corporation of which they were President and Treasurer, respectively. By innuendo, Respondent's counsel attempts to make this Court believe that the Fihes did appropriate corporate funds to their own use, which funds were never reported as taxable income.

This appears to be a deliberate attempt to make the Court believe that the Petitioners here are the guilty parties, when, in fact, it is undisputed that Harry Holly and the auditor for the corporation both were convicted and served terms in the Federal penitentiary for conspiring to defraud the Government of income taxes.

Respondent's counsel actually belies the statement regarding unfettered control of corporate funds on pages 7 and 16 of the typewritten brief by admitting that all checks drawn on the corporation by either of the Fihees were not valid unless *countersigned* by Holly or his wife. IS THIS UNFETTERED CONTROL?

Unreported Salary in 1948.

At several points in Respondent's typewritten brief, Albert J. Fihe is accused of having received salary from the corporation in the year 1948 which he did not report, pages 12, 17 and 31.

The actual facts, as borne out by the record, show that Fihe resigned as President of the corporation at the end of the third week in January of 1948. He had been paid his salary of \$400.00 per week up to that time.

Respondent's counsel insists that the corporation paid Fihe an additional amount of \$861.90, which Fihe did not report.

Query is made as to whether any corporation would continue to pay any salary to an officer after he had resigned and sold all his stock in the corporation.

Respondent's only witness, Wiscons, admitted, on cross-examination (record page 149), that he could not understand why any more money was paid Fihe as salary or

anything else in the year 1948, after Fihe had completely severed his connection with the corporation.

The above misstatements and actual falsifications tend to show that Respondent's counsel is trying to discredit the Fihes with this Court when, in fact, the alleged payments made to the Fihes by the corporation were set up on the corporate books long after the Fihes were "out of the picture" and apparently at the instigation of an ex-convict, namely Harry Holly, who was caught in his efforts to falsify the corporate books.

The Years 1946 and 1947.

Respondent's counsel devotes approximately three quarters of the typewritten brief to an analysis and discussion of the returns and additional taxes claimed for the above two years.

As explained in Petitioners' Opening Brief, the alleged discrepancies for these two years are relatively minor, and there is really no point in taking up this Court's time for such small amounts. In fact, Petitioners have indicated their willingness to pay these taxes, but believe that any *penalty* assessment is unfair and uncalled for.

Penalties.

The record and Respondent's brief conclusively show that Fihe employed a firm of certified public accountants to prepare the tax returns for both the partnership and the corporation for the years in question. In fact, amended partnership and other returns, prepared by these accountants Barrow, Wade & Guthrie, are Exhibits G to J, inclusive, here.

It is peculiar that the Judge of the Tax Court gave full credence to the revised partnership and corporation returns prepared by these same accountants, when ever there was a question of additional charges against the Fihes; but, when it came to assessing penalties against the Fihes for incomplete tax returns, the Tax Court completely ignored the fact that these returns were prepared by the same certified public accountants.

No Penalty Should Be Assessed Against the Fihes at Any Time or for Any Reason—the Year 1948.

As already fully explained in Appellants' Opening Brief, the additional assessment of taxes for the year 1948 is the main and possibly the only matter for consideration by this Court.

Petitioners' brief, pages 17 and 18, lists two methods of computing the 1948 tax, either of which would be a reasonable assessment.

On the other hand, the Commissioner and the Tax Court decided that the Fihes owed additional taxes for this year in the amount of approximately \$7,000.00.

Respondent's counsel submits a long list of figures in support of this alleged deficiency which, to say the least, simply adds to the confusion.

Perhaps "figures don't lie", but there were so many debits made against the Fihes accounts with the Holly corporation for the year 1948, practically all of which were wholly unsubstantiated (see Wiscons' testimony and admissions) and the Commissioner and Tax Court both arbitrarily disallowed so many proper deductions that there was a resultant additional tax assessment. Petitioners' Opening Brief comments on these unauthorized

and improper disallowances, and there is no point in repeating these comments.

Suffice it to say, that, as A. J. Fihe testified in Court, Harry Holly and his accountants did, after the Fihes sold their stock in the company, completely revise the Corporation books and made many absolutely false debits against the Fihes' accounts. This money went somewhere, but the Fihes never received it. As the trial record shows, both A. J. and Elizabeth Fihe continued to contribute money to the partnership and corporation in amounts averaging \$5,000.00 annually for many years. Any records to the contrary, and particularly those made after the Fihes severed their connection with the company, are absolutely and unqualifiedly false. [Record pp. 165, 171, 172, 211 and 243.]

1950 Carry-Back.

Petitioners further contend that, having experienced a severe financial loss in the year 1950, that this loss, when carried back to the year 1948, would eliminate any tax whatever for that year, no matter how figured. Respondent's counsel asserts that such is not in issue in this case, but Petitioners *are certainly entitled to a carry-back* and, therefore, request that the Court consider this question.

The Ethics, Morals and Equities.

Respondent's brief is entirely silent regarding the status of ex-convict Holly; his participation with the company auditor and an internal revenue agent in a conspiracy to defraud the Government of taxes.

Respondent's brief is also entirely silent regarding the part that the Fihes took in reporting this conspiracy and bringing the culprits to an accounting for their crime.

Respondent's brief also neglects to admit that this action on the part of the Fihe saved the Government untold sums of money, first in the actual matter at issue here and also by discouraging future similar acts by others.

Petitioners are morally, legally and ethically right, and recognition of this situation by this Honorable Court is earnestly solicited.

Respectfully submitted,

ALBERT J. FIHE,

Attorney for Petitioners-Appellants.

No. 15,726

**In the United States Court of Appeals
for the Ninth Circuit**

ALBERT J. FIHE AND ELIZABETH FIHE, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF AND APPENDICES FOR THE RESPONDENT

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JUL 14 1958

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**In the United States Court of Appeals
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No. 15,726

ALBERT J. FIHE AND ELIZABETH FIHE, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF AND APPENDICES FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 47-73) are not officially reported.

JURISDICTION

This petition for review (R. 76-79) involves federal income taxes for the taxable years 1946, 1947, 1948 and 1949. On January 14, 1954, the Commissioner of Internal Revenue mailed to taxpayers notices of deficiencies in the total amount of \$16,839.16 and of 5% negligence penalties in the total amount of \$1,355.87. (R. 7-11, 18-29.) Within ninety days thereafter, on April 8, 1954, taxpayers filed petitions with

the Tax Court for a redetermination of those deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3-29.) The decisions of the Tax Court were entered April 30, 1957, (R. 73-75.) The case is brought to this Court by a petition for review filed July 29, 1957. (R. 76-79.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court was correct in upholding the Commissioner's determination that taxpayers understated their business income for each of the years 1946 through 1949 and claimed excess itemized deductions for the years 1947 through 1949.

2. Whether the Tax Court was correct in upholding the Commissioner's determination that taxpayers understated income received by them from Holly Molding Devices, Inc., for the years 1947 and 1948.

3. Whether the Tax Court was correct in upholding the Commissioner's determination that taxpayers understated long-term capital gain received by them in 1948 from the sale of their stock in Holly Molding Devices, Inc.

4. Whether the Tax Court was correct in upholding the Commissioner's determination that part of taxpayers' deficiencies for 1946, 1947 and 1948 was due to negligence, and that taxpayers were liable for the 5% addition to tax for each of these years under Section 293(a) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions are set forth in Appendix A, *infra*.

STATEMENT

The relevant facts as found by the Tax Court (R. 48-52, 55-61, 65-68, 72) may be summarized as follows:

Taxpayers are husband and wife. The taxpayer-husband filed a separate return for 1946, and both taxpayers filed joint returns for 1947, 1948 and 1949.¹ The taxpayer is a practicing attorney specializing in patent law for some thirty-four years. He maintained an office in Chicago for that length of time, closing it in 1948. He has had an office in Los Angeles, California, for thirty years. Taxpayer and his wife, Elizabeth, moved from Chicago to California in 1948. (R. 48.)

In 1936 taxpayer and his wife formed a partnership, known as Holly Molding Devices, with Harry Holly and Holly's wife. The partnership engaged in the manufacture and sale of hamburger molds. Holly was the inventor of the device, and taxpayer furnished his services in procuring the patent. Elizabeth was a member of the partnership in 1946, having a one-fourth interest therein. (R. 48-49.)

After taxpayer and his wife moved to California in 1948, taxpayer engaged in the practice of patent law and the manufacture and sale of fishing equipment. (R. 49.)

Issue No. 1

The Commissioner determined that taxpayer understated his business income for each of the years 1946, 1947, 1948 and 1949. The Commissioner also disallowed certain itemized deductions claimed by taxpayers for the years 1948 and 1949. (R. 49-51.)

¹ Whenever the term "taxpayer" is used in this brief it is intended to refer to Albert J. Fihe, taxpayer-husband; whenever the term "taxpayers" is used, it is intended to refer to Albert J. Fihe and his wife, Elizabeth M. Fihe.

With respect to 1946 the Commissioner determined that taxpayer understated his business income by \$5,015.58 as follows (R. 49):

Expense	Claimed	Allowed	Disallowed
(1) Litigation Expense.....	\$5,720.30	\$4,720.30	\$1,000.00
(2) Travel expense.....	4,763.77	3,226.30	1,537.47
Total disallowed expenses.....			\$2,537.47
(3) Unreported income—Los Angeles office.....			749.69
Total.....			\$3,287.16
(4) Loss, Los Angeles office, claimed on amended return, disallowed.....			(1,728.42)
Adjustment—increase in business income.....			<u>\$5,015.58</u>

For 1947 the Commissioner determined that taxpayer had understated his business income by \$5,546.17 as follows (R. 49):

Expense	Claimed	Allowed	Disallowed
(1) Legal.....	\$4,269.26	\$1,669.26	\$2,600.00
(2) Travel.....	5,881.56	4,433.61	1,447.95
(3) Advertising.....	1,042.97	487.97	555.00
Total disallowed expenses.....			\$4,602.95
(4) Gross receipts understated.....			943.22
Adjustment—increase in business income.....			<u>\$5,546.17</u>

The \$2,600 of legal expenses which the Commissioner disallowed represented the payment by taxpayer of legal fees for Harry Holly in connection with the defense of a criminal action against Holly. (R.49.)

The Commissioner adjusted taxpayer's 1947 income in taxpayer's favor by allowing a net operating loss carry back from 1949, as follows (R. 50):

Business income (loss) per return.....	(\$3,151.10)
Increase per above adjustment.....	5,546.17
Business income as adjusted.....	<u>\$2,395.07</u>
Less:	
Net operating loss from 1949 allowed.....	20,761.06
Business income (loss) as adjusted.....	(18,365.99)
Business loss claimed on return.....	(3,151.10)
Adjustment—decrease in net income.....	<u>\$15,214.89</u>

The Commissioner also disallowed certain itemized deductions claimed by taxpayer for 1947, as follows (R. 50):

Deductions	Claimed	Allowed	Disallowed
(1) Contributions.....	\$ 448.15	\$ 356.15	\$ 92.00
(2) Taxes.....	7,680.88	1,397.50	6,283.38
(3) Medical—Disallowed because of percentage limitation			

The amount disallowed for taxes included federal income and other federal taxes, such as transportation, amusement and “Pullman” taxes. (R. 52.)

For 1948 the Commissioner determined that taxpayer understated his business income by \$16,387.10, as follows (R. 50-51):

Expense	Claimed	Allowed	Disallowed
(1) Interest.....	\$3,111.84	\$2,876.44	\$ 235.40
(2) Taxes.....	2,600.84	2,089.55	511.29
(3) Losses.....	3,362.44	0	3,362.44
(4) Freight.....	1,630.41	505.96	1,124.45
(5) Legal.....	3,326.14	2,764.39	561.75
(6) Stationery.....	2,794.47	2,644.47	150.00
(7) Travel.....	8,679.14	2,876.17	5,802.97
(8) Commissions.....	1,426.30	626.30	800.00
(9) Advertising.....	3,483.94	2,885.80	598.14
(10) Repairs.....	535.33	460.76	74.57
(11) Postage.....	732.18	488.85	243.33
(12) Phone & Telegraph.....	1,323.41	1,251.88	71.53
(13) Depreciation.....	2,755.11	773.53	1,986.58
Total Disallowed expenses.....			\$15,522.45
(14) Add: Error in addition of deductions on return.....			584.20
(15) Unreported Receipts.....			280.45
Adjustment—increase in business income.....			<u>\$16,387.10</u>
Business income (loss) per return.....			(\$33,363.88)
Increase per above adjustment.....			<u>16,387.10</u>
Business income (loss) as adjusted.....			<u>(\$16,976.78)</u>

The amounts claimed as business expenses for freight and travel expenses included the cost of moving taxpayers’ personal possessions from Chicago to California and the cost of maintaining the family in a hotel until a new home was established. Taxpayer also deducted automobile expenses which included the cost of travel to and from work. He also deducted the cost

of new suits as advertising expenses and testified in that connection, "If I do not look pretty prosperous, I do not get patent business," and "I think it is perfectly good advertising and the only way a lawyer can advertise." (R. 52.) The Commissioner disallowed these amounts.

For 1948 the Commissioner also disallowed certain itemized deductions claimed by taxpayer, as follows (R. 51):

Deductions	Claimed	Allowed	Disallowed
(1) Contributions.....	\$ 664.48	\$ 291.25	\$ 373.23
(2) Casualty loss.....	2,300.04	0	2,300.04
(3) Medical.....	1,089.34	735.79	Percentage limitation

The casualty loss of \$2,300.04 claimed by taxpayer was asserted to be for "Damaged and stolen furniture and stolen wallet." Of this amount \$214 represented cash which, according to taxpayer's records, was stolen from a wallet, and the remainder represented the cost of purchasing new furniture to replace furniture which taxpayer claimed was lost, stolen and damaged in the move to California. (R. 52.)

The year 1949 is here involved to the following extent: As shown in Issue No. 3, *infra*, the Commissioner contended, and the Tax Court agreed, that the sale of taxpayers' stock in the Holly corporation took place in 1948 and not in 1949. Accordingly, taxpayer's 1949 income was reduced and the reduction resulted in a net operating loss for that year which was carried back to 1947. (R. 27-29.) The Commissioner, however, made other adjustments to taxpayer's 1949 reported income, in the total amount of \$10,602.38, as follows (R. 51):

	Expense	Claimed	Allowed	Disallowed
(1)	Repair.....	\$2,517.15	\$ 407.13	\$ 2,110.02
(2)	Advertising.....	3,658.25	976.59	2,681.66
(3)	Litigation.....	1,042.22	794.82	247.40
(4)	Travel.....	4,476.41	2,493.24	1,983.17
(5)	Interest.....	3,909.95	3,308.89	601.06
(6)	Postage.....	720.32	471.32	249.00
(7)	Depreciation.....	2,550.40	1,843.23	707.17
(8)	Telecast expense.....			1,661.62
(9)	Bandmaster.....			632.50
	Total disallowed expenses.....			\$10,873.60
(10)	Receipts understated.....			628.78
	Total.....			\$11,502.38
	Less: Mathematical error.....			900.00
	Net increase in business income.....			\$10,602.38

The Commissioner also disallowed certain of the itemized deductions claimed in 1949 by taxpayer, as follows (R. 51):

	Deductions	Claimed	Allowed	Disallowed
(1)	Contributions.....	\$ 285.51	\$47.51	\$ 238.00
(2)	Interest.....	3,909.95	-0-	3,909.95
(3)	Taxes.....	3,511.44	-0-	3,511.44

The Tax Court sustained *in toto* the above adjustments made by the Commissioner for 1946, 1947, 1948 and 1949. (R. 52-55.)

Issue No. 2

On or about September 25, 1946, taxpayer and the Hollys formed a corporation known as Holly Molding Devices, Inc., the name of which was later changed to Hollymatic Corporation (hereafter called the corporation) to carry on the business formerly carried on by the former partnership, Holly Molding Devices. With the exception of certain improved real estate which was distributed to the former partners, all the assets and liabilities of the partnership were turned over to the corporation in exchange for capital stock to be issued to the former partners. The real estate was rented to the corporation for a time by the former partners. (R. 55.)

Taxpayer was named president of the corporation and his wife was named treasurer. During 1946 and 1947 taxpayer was in charge of the corporation's books and records. In 1947 he employed a firm of certified public accountants to audit the books. (R. 55.)

Both taxpayer and his wife had authority to draw checks on the corporation provided such checks were countersigned by either Harry Holly or his wife. Prior to the sale by taxpayer and his wife of their stock in the corporation, corporate checks issued by Holly or his wife were required to be countersigned by one of the taxpayers. (R. 55-56.)

For 1947 the corporation's books and records reflect that credits were made to the personal account of taxpayer and his wife in the corporation in the respective amounts of \$23,998.74 and \$1,175, that disbursements were made by checks by the corporation to taxpayer and his wife in the amount of \$36,523.99, and that debits were made to the personal accounts of taxpayer and his wife in the respective amounts of \$7,305.22 and \$1,410.04 (R. 56-61.) These items are as follows:

For 1947 the corporation's books and records reflect salary paid or credited to taxpayer of \$25,920. According to these books and records \$14,000 of salary, less withholding of \$2,476.90, or a net amount of \$11,523.10 was paid to taxpayer, and \$10,706.20 of salary was credited to his personal account. (R. 56.)

The \$23,998.74 of credits made to taxpayer's personal account in the corporation are as follows (R. 56-57):

\$ 724.18	Loan to corp.
10,706.20	Accrued salary
140.00	Accrued rent
5,123.03	Patent Installment payments (later reversed)
6,227.21	Patent Installment payments
100.00	Rent
918.12	Minimum on royalties
60.00	Accrued Rent

The \$1,175 of credits made to the personal account of taxpayer's wife in the corporation are as follows (R. 57):

\$875	to correct advances
140	accrued rent
100	accrued rent
60	accrued rent

As to the \$36,523.99 of disbursements made by the corporation in 1947 to taxpayer and his wife, the corporate books and records and/or the personal records maintained by taxpayer reflect the following amounts (R. 59):

1/10/47.....	\$ 1,000.00	
1/10/47.....	800.00	
3/17/47.....	800.00	
3/21/47.....	550.00	
4/30/47.....	3,000.00	
4/30/47.....	1,000.00	(Reflected as \$700 debit to petitioner and \$300 debit to Elizabeth; Reflected as one receipt on petitioner's personal records)
4/30/47.....	700.00	
4/30/47.....	2,325.00	
5/31/47.....	2,600.00	
6/30/47.....	2.94	
6/30/47.....	3,632.05	
6/30/47.....	408.54	
9/30/47.....	5,890.00	
12/ 5/47.....	2,292.36	
Add.....	11,523.10	(Representing amounts disbursed by check, roughly net of withholding tax, as per corporate records, and petitioner's personal records)
Total.....	\$36,523.99	

(Note: Above total does not include the \$1,000 option payment of December 13, 1947, hereafter referred to.)

An examination of these disbursements reveals the following: The corporation books and records reflect disbursements by check of \$1,000 to taxpayer and \$800 to his wife on January 10, 1947. These disbursements were debited to their personal accounts. The personal records maintained by taxpayer reflect receipt of this \$1,800 amount on January 11, 1947. (R. 57.)

The corporation books and records reflect a disbursement by check on March 17, 1947, of \$800 debited to the personal account of taxpayer. The personal records maintained by taxpayer reflect a cash receipt of \$800 from the corporation on March 15, 1947. (R. 57.)

The corporation books and records reflect a disbursement by check of \$3,000 to taxpayer which was debited to his personal account on April 30, 1947. The personal records maintained by taxpayer reflect a cash receipt of \$3,000 from the corporation on April 22, 1947. (R. 57.)

The corporation books and records reflect a disbursement by check on April 3, 1947, of \$1,000 which was allocated \$700 to taxpayer and \$300 to his wife and debited in such amounts to their personal accounts on April 30, 1947. The personal records maintained by taxpayer reflect a cash receipt of \$1,000 from the corporation on April 1, 1947. (R. 57-58.)

The corporation books and records reflect two additional disbursements by check of \$700 and \$2,325 in April which were debited to the personal account of taxpayer on April 30, 1947. The personal records maintained by taxpayer reflect cash receipts from the corporation of \$700 on April 17, 1947, and \$2,325 on April 26, 1947. (R. 58.)

The corporation books and records reflect that salary in the amount of \$14,000 was disbursed by checks to taxpayer in 1947. The personal records maintained by taxpayer reflect cash receipts of salary in the total amount of \$11,523.10. These are net amounts and do

not reflect withholding for income and social security taxes. (R. 58.)

The corporation books and records reflect a disbursement by check to taxpayer on June 20, 1947, of \$3,632.05 which was debited to his personal account on June 30, 1947. The personal records maintained by taxpayer reflect a cash receipt of \$3,632.05 from the corporation on June 25, 1947. (R. 58.)

The corporation books and records reflect a disbursement by check to taxpayer on May 13, 1947, of \$2,600 which was debited to his personal account on May 31, 1947. This check was issued to pay legal fees for Harry Holly pursuant to an agreement with taxpayer and the personal records maintained by taxpayer do not reflect this amount as a receipt of income. (R. 58.)

The corporation books and records reflect a debit of \$5,890 to taxpayer's personal account on September 30, 1947. The personal records maintained by taxpayer reflect a cash receipt of \$5,890 from the corporation on September 12, 1947. (R. 59.)²

² No explanation was made by the Tax Court as to the disbursements by checks made by the corporation to taxpayer and his wife on March 21, 1947, in the amount of \$550; on June 30, 1947, in the amount of \$2.94; on June 30, 1947, in the amount of \$408.54; and on December 5, 1947, in the amount of \$2,292.36. (R. 59.)

As to the \$7,305.22 of debits made to the personal account of taxpayer in 1947, and the \$1,410.04 of debits made to the personal account of his wife, the books and records of the corporation reflect the following debits which are not reflected on the personal records maintained by taxpayer (R. 60-61):

4/30/47	General Journal entry. To transfer advances to officers to proper accounts.....	\$ 350.00
4/30/47	G. J. entry. Charge back unauthorized salaries paid to executives in December.....	\$1,499.50
4/30/47	G. J. entry. To charge Mr. Fihe for items in equipment account covering Mr. Fihe's filing cabinets for patents and so forth.....	\$ 563.47
4/30/47	G. J. entry. To charge personal accounts for excess payments on taxes withheld.....	\$ 86.34
4/30/47	G. J. entry. To charge owners of building for mortgage and interest on same paid by the corporation...	\$ 256.25
4/30/47	G. J. entry. Interest on officers life insurance loans, paid by the company, charged back to the appropriate officers.....	\$ 61.58
4/30/47	G. J. entry. To charge portion of traveling expenses to respective officers.....	\$ 705.96
4/30/47	No explanation.....	\$1,199.28
4/30/47	To adjust salaries upon which tax has been paid and not deducted.....	\$ 3.50
4/30/47	Cash disbursement.....	\$ 2.94
9/17/47	G. J. entry. To charge interest on insurance loans to officers concerned.....	\$ 34.04
9/30/47	G. J. entry. To correct distribution of check No. 8737 charged to Workmen's Compensation Insurance in error. Insurance agent states that this does not cover a company policy.....	\$ 250.00
12/5/47	Check issued to Mr. Fihe. Explanation of "royalties" crossed out and no explanation given.....	\$2,292.36
Total.....		\$7,305.22

The books and records of the corporation reflect the following debits to the personal account of taxpayer's wife in 1947 which are not reflected in her personal records (R. 61):

3/21/47	Check payable to Mrs. Fihe.....	\$ 550.00
4/30/47	G. J. entry. To adjust salaries upon which tax has been paid and not deducted.....	\$ 1.75
4/30/47	G. J. entry. To charge back unauthorized salaries paid to executives in December.....	\$ 449.75
6/30/47	Check payable to Mrs. Fihe.....	\$ 408.54
Total.....		\$1,410.04

With the exception of an entry reflecting the payment of taxpayer's income tax by the partnership, the

books and records of taxpayer and his wife for 1947 reflect income only for items which were deposited in their bank account. (R. 61.) Thus, amounts which might constitute income were not reflected in their books and records unless received by them in the form of checks, cash or notes. Even checks or cash receipts were not recorded as income unless such amounts were deposited in their bank accounts; and salary payments received by taxpayer and deposited by him were accounted for only in net amounts. i.e., after withholdings.

The Commissioner determined from the corporation's books and records (see R. 62) that some \$25,920 was paid or credited to taxpayer as salary, or \$5,295 more than was reported as income by taxpayer and his wife in their joint return for 1947, some \$14,000 (less withholding) of salary having been disbursed to taxpayer by check and some \$10,706.20 having been credited to his personal account. Additionally, the Commissioner determined that the corporation's books disclosed that \$7,145.33 of net credits were made to taxpayer's personal account reflecting royalty payments,³ and hence income, and that \$600 was credited as rents to the personal accounts of taxpayer and his wife. Thus, the Commissioner determined that taxpayers had received or had unfettered command of \$33,665.33 for 1947, or at least \$10,056.57 more than they reported as taxable income from the corporation on their 1947 joint return. (R. 55-61.)

For the following year, 1948, taxpayer and his wife reported \$1,200 of salary received from the corpora-

³ Apparently taxpayer reported royalty payments of \$2,983.76 as salary from the corporation.

tion. The W-2 form attached to taxpayer's 1948 return reflected total wages of \$2,061.90. (Ex. E.) The corporate books and records reflect that taxpayer received salary, net after withholding tax, in 1948 in the form of corporate checks as follows (R. 60):

1/2/48.....	\$327.10 (\$72.90 withheld as taxes)
1/9/48.....	\$327.10 (\$72.90 withheld as taxes)
1/16/48.....	\$327.10 (\$72.90 withheld as taxes)
1/31/48.....	\$861.90

Taxpayers reported as income the first three checks but not the fourth check for \$861.90. The Commissioner determined that they had understated their 1948 income from the corporation by \$861.90. (R. 24, 64-65.)

The Tax Court sustained the Commissioner's determination that taxpayers had received from the corporation taxable income of \$10,056.57 for 1947 and \$861.90 for 1948 which they did not report. (R. 61-65.)

Issue No. 3

In December, 1947, taxpayers gave an option to the corporation whereby they agreed to sell to the corporation their capital stock, their interest in patents used by the corporation and their interest in certain improved realty. Taxpayers received a payment of \$1,000 for the option on December 13, 1947. (R. 65).

The improved realty involved in this transaction was real estate distributed to the individual partners upon dissolution of the partnership. It was conveyed to the corporation in 1948. The cost of the improved realty distributed to the four partners in September, 1946, was \$11,991.32. (R. 66.)

Taxpayer received his interest in the patents transferred to the corporation in exchange for his legal services in obtaining the patents. (R. 66.)

The assets and liabilities of the partnership, with the exception of the improved realty, were transferred to the corporation in exchange for capital stock. The capital accounts of the individual partners as of the date of the transfer of the partnership assets and liabilities to the corporation were as follows (R. 66-67):

H. H. Holly.....	\$8,174.57
Agnes Holly.....	8,174.57
Albert J. Fihe.....	8,174.57
Elizabeth M. Fihe.....	8,174.57
Total.....	<u>\$32,698.28</u>

At the time of the transfer, 200 shares of capital stock were issued by the corporation in the total amount of \$20,000 and paid in surplus was credited in the amount of \$12,698.28. Liabilities of the partnership to taxpayers in the total amount of \$8,122.78 were assumed by the corporation. (R. 67.)

In January, 1948, the corporation exercised the option and paid to taxpayers \$24,000 by check. In addition, the corporation gave to taxpayers two notes in the total principal amount of \$70,000, secured by a chattel mortgage on the corporate machinery and equipment. Further, a credit was entered to taxpayer's personal account on the corporate books in the amount of \$5,000 which settled a debit balance for that amount in his personal account. (R. 66.)

Commencing February 29, 1948, payments were made to taxpayers on the notes and mortgage in the amount of \$1,750 per month plus interest. These payments continued until the entire amount was paid. Taxpayers received payments on principal totalling \$17,500 in 1948. (R. 66.)

Taxpayers reported \$41,500 as the amount realized on the sale of their interests to the corporation and a

basis for such interests of \$27,624.36. (R. 67.) The \$41,500 sales price was apparently computed by adding the \$24,000 payment to the total of \$17,500 of monthly payments received in 1948, without recording the \$1,000 option payment received in December, 1947, or the \$5,000 credit to taxpayer's account.

Taxpayers computed on a separate schedule D the amount reported as net capital gain in their 1948 return but did not file the schedule of the return. Taxpayers, in computing the net capital gain reported on their 1948 return, deducted losses incurred in the sale of a personal residence and the sale of personal furniture and fixtures. The Commissioner disallowed the losses from the sales of the personal residence and of the furniture and fixtures. (R. 67.)

The Commissioner determined that taxpayers realized \$100,000 in 1948 from the sale of their interests to the corporation, as follows (R. 67-68):

Option payment (made in December, 1947).....	\$ 1,000
Cash payment (made in January, 1948).....	24,000
Credit to personal account of A. J. Fihe.....	5,000 ⁴
Face amount of notes and mortgage.....	70,000
	<hr/>
	\$100,000

Taxpayer asserted that he had a basis for the stock of \$27,624.36 upon the ground that he had advanced from \$36,000 to \$50,000 to the partnership and that these advances should be taken into consideration in computing his basis in the stock. (R. 70.) The Commissioner did not include such claimed advancements in his determination of basis, but determined a basis

⁴ The books and records of the corporation reflect this credit as of January 31, 1948, under the entry "To record purchase of patent rights, capital stock and land and buildings from A. J. and E. M. Fihe under option agreement dated 12/13/47." (R. 105, Appendix B, *infra*.)

for the stock of \$20,595.37, computed as follows (R. 68):

Basis of Patents.....	0	
Basis of Stock.....	\$16,349.14	
Basis of Real Estate:		
Cost.....	\$11,991.32	
Less: Depreciation (as adjusted by respondent).....	3,498.86	
	<u>\$ 8,492.46</u>	
Petitioners' share thereof (50% of \$8,492.46).....		4,246.23
		<u>\$20,595.37</u>

Additionally, taxpayers attempted to prorate the capital gain over the years 1948 and 1949 upon the grounds that they were entitled to report on the installment basis and that the notes were non-negotiable and had no fair market value. The Commissioner rejected this upon the grounds that the initial payments received in 1948 exceeded 30 per cent of the total sales price, so that taxpayers could not use the installment method of reporting the income, and that there was no evidence establishing that the notes had no fair market value. (R. 70-71.)

The Tax Court sustained the Commissioner's determination of capital gain. (R. 68-72.)

Issue No. 4

The Tax Court found that in 1940 a revenue agent admonished taxpayer to keep more accurate books and records and that for the years involved taxpayer kept incomplete books and records, which did not reflect the taxable income of himself and his wife. The Commissioner assessed a 5 per cent addition to tax for negligence for the years 1946, 1947, and 1948. (R. 72.) The Tax Court sustained the imposition of these additions. (R. 72-73.)

SUMMARY OF ARGUMENT

The issues raised by taxpayers on appeal are factual, as taxpayers concede. Consequently, the question before this Court is whether the Tax Court's conclusions are clearly erroneous. The record reveals that the Tax Court in arriving at its findings of fact carefully examined all of the evidence produced at the hearing, that it had the opportunity of judging the credibility of taxpayers' testimony, and that its findings are supported by substantial evidence. Accordingly, we submit that the Tax Court's determination that there were deficiencies in taxpayers' incomes for the years 1946 through 1949, and that part of the deficiencies for the years 1946, 1947 and 1948, was due to negligence, should not be disturbed on appeal.

A. For the years 1946 through 1949 taxpayers claimed large amounts of business and personal deductions. The Commissioner disallowed part of the claimed amounts, on the grounds that deductions for some of the claimed expenditures were expressly prohibited by the 1939 Code, that others were for personal rather than for business purposes, that in some instances the same item was deducted twice by taxpayer, and that taxpayer failed to substantiate his right to deductions for the amounts claimed for other classes of items. The Tax Court upheld the Commissioner's action and taxpayers do not even attempt to show, by argument or evidence as distinguished from broad, unsubstantiated assertions, that any of the claimed deductions were allowable.

B. For 1947 and 1948 the Commissioner determined that taxpayers failed to report as income all of the amounts received by them as such from the corpor-

ation. During this period taxpayer and his wife were president and treasurer of the corporation. Taxpayer was in charge of the corporation's books and records, and taxpayer and his wife could draw checks on the corporation provided such checks were countersigned by either of the Hollys.

It was determined, from a detailed audit of the corporation's books and records, and particularly from the personal accounts of taxpayers in the corporate books, that some \$25,920 was paid or credited to taxpayer's account as salary in 1947, that credits were entered in his account for \$7,145.33 as patent installment payments and that credits of \$600 as rent were entered in his account and that of his wife, for a total of \$33,665.33, or \$10,056.57 more than taxpayers reported in their incomes as having been received from the corporation in 1947. These obligations of the corporation to taxpayers were discharged either by the payment of checks to taxpayers or by debit entries reflecting payment to others of taxpayers' debts, or by cancellation by the corporation of debts owed to it by taxpayers. Taxpayers reported in their incomes only those amounts paid to them by checks which they deposited.

For 1948 the corporation paid a salary to taxpayer of \$2,061.90 and sent to him a Form W-2 listing this amount as total wages. Taxpayer, however, reported a salary received from the corporation of only \$1,200 and omitted the last payment of \$861.90.

The record therefore fully supports the Tax Court's findings that taxpayers understated their incomes received from the corporation for 1947 and 1948.

C. The Commissioner determined that taxpayers understated the long-term net capital gain received by

them in 1948 from the sale of their interests in the corporation. The record supports the Commissioner's determination and the Tax Court's findings as to taxpayers' adjusted basis in patents, stock and real estate sold by them. Taxpayers' contention that they should have a higher adjusted basis than determined by the Commissioner appears to depend primarily on their self-serving unsupported testimony that they previously had advanced between \$30,000 to \$50,000 to the corporation. Taxpayers failed to substantiate this contention, and the record clearly supports the Tax Court's refusal to place any credence in it.

The record also supports the Commissioner's determination and the Tax Court's findings as to the amount realized from the sale. The discrepancies between the Commissioner's determination and taxpayer's figures result from the fact that taxpayers failed to include a \$1,000 option payment and a \$5,000 credit made by the corporation to taxpayer's personal account, and from the fact that the Commissioner included in his determination of sales price for 1948 the \$70,000 face amount of notes and mortgage received by taxpayers in that year, whereas taxpayers included only \$17,500 of installment payments on the notes received during that year.

Taxpayers contend that they did not include the face amount of the note in the sales price because the notes were non-negotiable and that they and the chattel mortgage securing them were worthless. However, the record supports the Tax Court's findings that the notes had value equal to their face amount. The notes were given by the corporation in satisfaction of an obligation to pay a fixed amount; the notes were secured and bore

interest; no evidence was introduced to show that the value of the chattel mortgage was less than the face amount of the note, or that the property subject to the mortgage was subject to foreclosure and quick sale for an amount less than the face amount of the notes, or that the notes were subject to conditions affecting their payment. In fact, as the Tax Court found, the notes were paid strictly according to their tenor in a comparatively short time. Accordingly, the Tax Court did not err in upholding the Commissioner's determination of value and in holding that taxpayers failed to meet their burden of proving affirmatively that the notes had a fair market value less than their face amount.

Since taxpayers received at least \$41,500 in cash during 1948 they cannot report their payments under the installment method permitted by Section 44(b) of the 1939 Code, for these initial payments exceed 30 per centum of the selling price.

D. In contrast to the assessment of fraud penalties, the Commissioner does not have the burden of proving negligence. Instead, the burden rests upon a taxpayer to overcome the presumptive correctness of the Commissioner's determination. The record in this case amply supports the Commissioner's determination and the Tax Court's findings that part of the deficiencies for 1946 through 1948 was due to negligence. Taxpayer has been a practicing attorney for many years and appears to have had considerable business ~~expense~~. In 1940 he was admonished by a revenue agent to keep more accurate books for his law practice and for any business with which he might be associated. Nevertheless, for 1946 through 1948 he claimed many deductions for items which were patently not deductible, he took

duplicate deductions for the same item, he failed to disclose the true nature of many of the claimed deductions, and he failed to include in his income amounts paid or credited to his account and made available for his use by the corporation, or even the full amount of salary paid to him by the corporation which was listed in the W-2 form given to him by the corporation and which he attached to his 1948 return.

ARGUMENT

The Tax Court Was Correct in Upholding the Commissioner's Determination That There Were Deficiencies in Taxpayers' Reported Incomes for 1946, 1947, and 1948, and That at Least Part of These Deficiencies Was Due to Negligence, So That Taxpayers Were Liable for the 5% Addition to Tax for Each of These Years under Section 293(a) of the Internal Revenue Code of 1939

The four issues involved in this appeal—(A) whether taxpayer understated his business income for the years 1946 through 1949 by claiming excessive itemized deductions and by understating business receipts; (B) whether taxpayers understated income received by them from the Holly Corporation for 1947 through 1948; (C) whether taxpayers understated the amount of long-term capital gain realized by them in 1948 upon the sale of their interests in the corporation; and (D) whether any part of the deficiencies asserted to be owing for the years 1946, 1947, and 1948 was due to negligence on the part of taxpayers—are “almost all strictly factual”, as taxpayers concede in their brief (p. 8).⁵

Taxpayers' main argument upon appeal consists of assertions that the Commissioner acted arbitrarily in assessing deficiencies and negligence penalties against

⁵ Taxpayers refer in their brief to a 1950 carry-back loss to 1948 (Br. 9, 19) but no such issue is involved in the case.

them and that taxpayers did not receive the amounts of income attributed to them by the Commissioner. (See Br. 19, 21, 22, 23-24.) These assertions are without merit. The record clearly shows that the Commissioner made a very thorough audit of taxpayer's records and of the books and records of the corporation before determining that there were deficiencies in taxpayers' incomes and that at least part of these deficiencies resulted from taxpayers' negligence. Similarly, the record reveals that the Tax Court carefully examined all the evidence in making its findings of fact and concluded that there was no basis, evidentiary or otherwise, for any of taxpayer's claims. (R. 52-55.)

The sole question on appeal, therefore, is whether the Tax Court's ultimate conclusions on these factual issues are clearly erroneous. In that connection it should be noted that such conclusions were based in part upon the Tax Court's appraisal of the testimony of taxpayer and his wife, who made self-serving statements without any substantiation. Thus, upon review the standard fixed by Rule 52(a) of the Federal Rules of Civil Procedure is applicable, namely that "due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses."⁶ The Tax Court's factual conclusions are therefore plainly

⁶ See Section 7482(a) of the Internal Revenue Code of 1954 (26 U.S.C. 1952 ed., Supp. II, Sec. 7482); *United States v. Oregon Med. Soc.*, 343 U.S. 325, 331-332; *United States v. Real Estate Boards*, 339 U.S. 485, 495-496; *United States v. Yellow Cab Co.*, 338 U.S. 338, 341-342; *Walling v. General Industries Co.*, 330 U.S. 545, 550; *Grace Bros. v. Commissioner*, 173 F. 2d 170, 173-174 (C.A. 9th); *Cohn v. Commissioner*, 226 F. 2d 22 (C.A. 9th); *Golden Construction Co. v. Commissioner*,¹ 228 F. 2d 637, 638 (C.A. 10); *Coates v. Commissioner*, 234 F. 2d 459, 462-463 (C.A. 8th); *Wis. Memorial Park Co. v. Commissioner* (C.A. 7th), decided May 16, 1958 (1 A.F.T.R. 2d 58-716).

entitled to finality. *United States v. Gypsum Co.*, 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869. "Here, the decision below was consistent with findings which on the evidence were well within the province of the trier" of the facts. *Chesbro v. Commissioner*, 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995. The Tax Court was not obliged to believe the self-serving testimony of taxpayer and his wife whether or not it was contradicted or where it was patently unconvincing. Neither was the Tax Court bound to accept their testimony "when there are facts which even indirectly may give rise to inferences contradicting the witness" as here. *Cohan v. Commissioner*, 148 F. 2d 336, 337 (C.A. 2d); *Greenfeld v. Commissioner*, 165 F. 2d 318, 319-320. (C.A. 4th).

A. The Tax Court was correct in upholding the Commissioner's determination that taxpayer understated his business income from 1946 through 1949 by claiming excessive itemized deductions

The first issue involves the business income taxpayer derived from his practice of law in the years 1946 through 1949 and from the manufacture of fishing equipment in 1948 and 1949. The Commissioner's determination that taxpayer had understated his net income from these sources resulted principally from the disallowance of certain claimed expenses, either totally or in part. Part of the deficiency also resulted from an understatement of business receipts during these years. Taxpayer does not appear to contest these latter amounts on appeal.

As is shown in the Commissioner's ninety-day letters (R. 8-11, 20-29) and the Tax Court's findings of fact (R. 49-52), taxpayer claimed a wide variety of item-

ized business and personal deductions. Of the items in controversy for 1946, taxpayer claimed \$10,484.07 as business expenses. The Commissioner allowed \$7,946.60 of the claimed amount and disallowed \$2,537.47. For 1947 taxpayer claimed \$11,193.79 as business expenses. The Commissioner allowed \$6,590.84 and disallowed \$4,602.95. Also for 1947 taxpayer claimed at least \$8,129.03 of personal deductions. The Commissioner allowed \$1,753.65 and disallowed \$6,375.38. For 1948 taxpayer claimed \$35,761.55 as business expenses. The Commissioner allowed \$20,244.10 and disallowed \$15,522.45. Also for 1948 taxpayer claimed \$4,053.86 as personal deductions. Of these the Commissioner allowed \$1,027.04 and disallowed \$3,026.82. For 1949 taxpayer claimed over \$21,168.82 as business expenses. The Commissioner allowed \$10,295.22 and disallowed \$10,873.60. Also, for 1949 taxpayer claimed \$7,706.90 as personal deductions. Of these the Commissioner allowed \$47.51 and disallowed \$7,659.39. A brief review of some of these disallowed items reveals that the Tax Court did not err when it upheld the Commissioner's determinations.

Initially, it is appropriate to point out the well established rules governing the right of a taxpayer to claim deductions, namely, that their allowance is a matter of legislative grace which does not turn on general equitable considerations but depends upon the existence of a clear statutory provision as to which the burden of proof falls upon the taxpayer (*Deputy v. du Pont*, 308 U.S. 488, 493), that the Commissioner's disallowance of a deduction has the support of a presumption of correctness, and that the taxpayer has the additional burden of proving it to be wrong (*Welch v. Helvering*, 290 U.S. 111, 115).

The items which were disallowed here, either in whole or in part, fall into three separate categories. The first category consists of items the deductibility of which is expressly prohibited by the 1939 Code. For example, taxpayer sought to deduct federal income taxes paid by him. (Ex. D.) This is expressly prohibited by Section 23(c)(1)(A) of the 1939 Code (Appendix A, *infra*). For 1947 and 1948 taxpayer attempted to deduct all his medical expenses despite the limitation expressed in Section 23(x) of the 1939 Code (Appendix A, *infra*), that only amounts which exceed 5 per cent of a taxpayer's gross income may be deducted. Thus, the Commissioner was clearly correct in denying a deduction for amounts which did not exceed 5 per cent of taxpayer's gross income in each of the years 1947 and 1948.

The second category of disallowed deductions consists of items which would not be deductible under Section 24 of the 1939 Code (Appendix A. *infra*) if they were made for personal rather than business reasons and were not otherwise deductible under some provision of Section 23. For example, taxpayer testified that in 1947 the \$2,600 claimed as a business deduction for legal expenses was paid to assist Holly, his partner in defending himself against criminal charges because (R. 206) "Harry had a family * * * and I really hated to see my partner go to the penitentiary, so I offered to pay his legal fee which amounted to \$2,600.00 * * *." Although, as the Tax Court states (R. 53-54), this "testimony evidence a charitable motive, it does not establish the basis for a business deduction." *Friedman v. Delaney*, 171 F. 2d 269 (C.A. 1st), certiorari denied, 336 U.S. 936.

Taxpayer also claimed such items as the cost of new suits as advertising expense, testifying (R. 245) "If I do not look pretty prosperous, I do not get the patent business", and "Yes, I think it is perfectly good advertising and the only way a lawyer can advertise." Taxpayer claimed the loss on the sale of furniture in Chicago and claimed the cost of moving personal furniture and possessions from Chicago to Los Angeles as a business expense. (R. 167.) These are clearly personal, non-deductible expenditures.

Taxpayer also claimed deductions for travel expenses of his business, the costs incurred in maintaining his family in a hotel upon his move to Los Angeles and before his new home was established (R. 245), and the cost of driving his automobile to and from work (R. 245-246). Clearly these expenses also are personal and not deductible, and are not incurred "in carrying on" a business under Section 23(a)(1) of the 1939 Code (Appendix A, *infra*). *Commissioner v. Flowers*, 326 U.S. 465; *York v. Commissioner*, 160 F. 2d 385 (C.A. D.C.); *United States v. Woodall* (C.A. 10th), decided May 6, 1958 (1 A.F.T.R. 2d 58-1771); *Caragan v. Commissioner*, 197 F. 2d 246, 249-250 (C.A. 2d); Section 29.23(a)-15(b), Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939.

The third category of deductions claimed by taxpayer and disallowed by the Commissioner consists of items which are normally deductible. In the present case, however, the Commissioner denied some of the claimed deductions, either in whole or in part, upon the ground that taxpayer had failed to substantiate the claimed amounts or that the same items were deducted twice in the same year by taxpayer.

For example, in 1948 taxpayer claimed a loss for personal property—furniture—which was claimed to have been damaged in transit from Chicago to Los Angeles and for a valuable ring and wallet claimed to have been lost in transit. (R. 212, 257.) The sole evidence in support of this deduction is taxpayer's testimony (R. 212):

In that connection, when we moved our furniture out here [to California], it was certainly in a wreck somewhere, because when we got it, most of it was almost irreparably damaged—a beautiful marble top table that we had was just broken into smithereens—some of the fine furniture looked as if it had been dragged through the mud. The upholstery was torn and almost beyond repair. Some valuable lamps were gone completely. My wife had a very valuable ring somewhere in that furniture and it never did get here. May I say that at one time I saw my wife weeping very bitterly when she saw that furniture.

For all that appears in the record, these losses (hardly casualty losses) may have been covered by insurance or claims may have been made against the movers. The Tax Court correctly denied the claimed deduction for the following reason (R. 55):

This record falls far short of furnishing a basis for allowing the casualty loss. There was no evidence regarding the loss of cash in a wallet. No fair market value of the damaged furniture has been proved and no basis for the property has been shown. The claimed loss is disallowed for lack of proof. See *Helvering v. Owens*, 305 U.S. 468.

Duplicated items of claimed deductions included two deductions in 1949 for a \$3,909.95 interest payment which taxpayer himself conceded (R. 17, 209, 246) was deducted both as a business expense and as a personal expense. Taxpayer also conceded (R. 17, 246-247) that in 1949 he deducted \$3,511.44 for taxes twice on his return.

As we have already indicated, the only arguments offered by taxpayers to support the claimed deductions are general statements to the effect that the Commissioner's disallowances (and inferentially the Tax Court's findings) are "unfair", "ridiculous" and "indicative of the antagonistic, belligerent and entirely unreasonable attitude of one or more of the agents or their superiors." (Br. 19, 20, 21, 23-24.) Such statements are unwarranted and certainly do not substantiate his right to the claimed deductions. *Depurty v. du Pont, supra*. Thus, the Tax Court was clearly correct in holding that taxpayer failed to meet his burden of proof and in sustaining the Commissioner's determination that taxpayer had understated his business income for the years 1946 through 1949.

B. *The Tax Court was correct in upholding the Commissioner's determination that taxpayers understated income received by them from the Holly Corporation in 1947 and 1948*

During 1947 and part of 1948 taxpayer and his wife were president and treasurer, respectively, of the Holly Corporation. Taxpayer was in charge of the corporation's books and records. Both taxpayer and his wife had authority to draw checks on the corporation provided such checks were countersigned by either Mr. or Mrs. Holly.

The revenue agent conducted an investigation of the corporation's books. A deposition was taken of Frank H. Wiscons, who has been comptroller of the corporation since 1948 and during 1946 and 1947 was its purchasing agent. (R. 81-154.) Wiscons testified as to the entries in the taxpayers' personal accounts in the corporation's books for the period October 1, 1946, through January 31, 1948. The Commissioner determined from these entries that taxpayers had understated their incomes from the corporation by \$10,056.57 in 1947 and \$861.90 in 1948. The Tax Court sustained the Commissioner's determinations. (R. 55-65.)

It is clear that where corporate funds are diverted to the personal use of a large or controlling stockholder or funds are made subject to his unfettered control without substantial limitation or restriction as to time, manner or condition of payment, such funds constitute income to him. *Lash v. Commissioner*, 245 F. 2d 20 (C.A. 1st); *Ross v. Commissioner*, 169 F. 2d 483 (C.A. 1st). See *Davis v. United States*, 226 F. 2d 331, 334-335 (C.A. 6th), certiorari denied, 350 U.S. 965; *Dawkins v. Commissioner*, 238 F. 2d 174 (C.A. 8th); *Chesbro v. Commissioner*, 21 T.C. 123, affirmed *per curiam*, 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995; *Burns v. Commissioner*, 31 F. 2d 399 (C.A. 5th), certiorari denied, 280 U.S. 564. Such is the case here.

The corporation's books and records disclose that \$25,920 was paid or credited as salary to taxpayer in 1947. According to these books some \$14,000, less withholding, of this amount was disbursed to taxpayer by check and \$10,706.20 was credited to his personal account on April 30, 1947. (R. 86-89.) The corporation's books further disclose that \$7,145.33, consisting of a credit of \$6,227.21 on September 30, 1947 (R. 101-

102), and a credit of \$918.12 on December 20, 1947 (R. 103), was made to the personal account of taxpayer as patent installment payments ⁷ and that \$600, consisting of two credits of \$140 each on April 30, 1947 (R. 93, 112-113), two credits of \$100 each on September 30, 1947 (R. 102, 133), and two credits of \$60 each on December 30, 1947 (R. 103, 113-114), were made to the personal accounts of taxpayer and his wife. These items amount to \$33,665.33, or \$10,056.57 more than taxpayers reported as receiving from the corporation on their joint return for 1947.

Taxpayers contend, among other things (Br. 11), that alleged changes in the corporation's books "showed quite a bit of money either charged to the Fihe's account or showing money that was presumably paid to them and which they did not get [R. 211]." It should be noted that taxpayer does not contest the fact that he received the \$14,000 of salary. His contention appears to be only that he did not receive any of the amounts for salary, patent payments and rent which were credited to his personal account with the corporation. This contention is refuted by an examination of this account.⁸

The personal accounts of taxpayers on the corporation books are liability accounts. Accordingly, credits to these accounts reflect liabilities of the corporation to taxpayers and debits reflect payments of such liabilities. These debits were in addition to the \$14,000 in salary already mentioned, which was paid to him directly and not run through the liability account.

⁷ This \$7,145.33 figure does not include a credit of \$5,123.03 made to taxpayer's personal account on April 30, 1947, which was reversed as of the same date. (R. 93, 97-98.)

⁸ An analysis is set forth in Appendix B, *infra*.

The personal accounts reflect liabilities of the corporation to taxpayer for additional salary in the amount of \$10,706.20; for patent installments, \$7,145.33; for rent, \$300; and for rent to taxpayer's wife, \$300. These liabilities were discharged in 1947 by payments by check or in cash and by debits to taxpayers' personal accounts. The fact that the liabilities were discharged in 1947 makes the amounts thereof taxable income in that year to taxpayers, who reported their income on the cash basis.

During 1947 payments in cash to taxpayer amounted to \$2.94 (R. 99); those by check amounted to \$14,049.41 and were as follows:

Record Page	Date of Book Entry	Amount
91.....	1/31/47	\$1,000.00
91.....	3/31/47	800.00
92.....	4/30/47	700.00
92.....	4/30/47	700.00
92.....	4/30/47	2,325.00
98-99.....	5/31/47	2,600.00
99.....	6/30/47	3,632.05
102.....	12/30/47	2,292.36
		<hr/> \$14,049.41

During 1947 payments by check and debits to taxpayer's wife's personal account amount to \$2,058.54, as follows:

Record Page	Date of Book Entry	Amount
109.....	1/31/47	\$ 800.00
109.....	3/31/47	550.00
110.....	4/30/47	300.00
112-113.....	6/30/47	408.54
		<hr/> \$ 2,058.54

Taxpayer's personal account for 1947 also shows payment of some \$13,899.92 by debits⁹ whereby the corpo-

⁹ The \$5,123.03 reversing entry relating to patent payments of April 30, 1947 (R. 93, 97-98), is not included in this amount.

ration's obligations to him were discharged. His wife's personal account for 1947 lists some \$707.75 of debits (in addition to the previously mentioned payments by check) in discharge of the corporation's liability to her.

The nature of the debits in the personal account of the taxpayer is reflected by the following: Of the debit entries made on April 30, 1947, the entry of \$350 (R. 94-95) reveals that that amount was paid to taxpayer as salary; the entry of \$563.47 (R. 95) indicates that the corporation paid for filing cabinets belonging to taxpayer; the entry of \$256.25 (R. 96) indicates that the corporation paid mortgage and interest payments on taxpayer's property; the entry of \$61.58 (R. 96-97) indicates that the corporation paid interest on taxpayer's life insurance; the entry of \$705.96 (R. 97) indicates that the corporation paid taxpayer's travel expenses; the entry of \$34.04 of September 30, 1947 (R. 100), indicates that the company paid interest on taxpayer's insurance loans; the entry of \$5,890 (R. 100-101) indicates that taxpayer had been making withdrawals of cash from the corporation; the entry of \$250 (R. 101) indicates that the company had paid for taxpayer's policy; etc.

The debits in the personal account of the taxpayer's wife for 1947 of \$707.75 (in addition to the check payments) include an entry of April 30, 1947, of \$449.75 (R. 110) for salary which had been paid but not charged to her; an entry of \$1.75 (R. 110-111) to adjust social security taxes paid for her benefit, and an entry of \$256.25 (R. 96, 111) which indicates that the corporation had made mortgage and interest payments on a building owned by her.

To recapitulate, the Commissioner has charged taxpayers with the receipt in 1947 of \$18,451.53 in income over and above the approximately \$14,000 paid to taxpayer as salary without being run through his personal account, and the receipt of that additional income in the amount of \$18,451.53 is amply shown by the books of the corporation as having been paid in cash (\$2.94), checks issued directly to taxpayers (\$16,110.89), and payments to others for taxpayers' benefit together with payments or withdrawals in cash (\$8,111.30), as shown by the above examples. The latter amount does not even include all of the items that might have been charged to taxpayers as income.

Further, taxpayer's personal account reveals (Appendix B, *infra*) that on January 1, 1947, the corporation was indebted to taxpayer for \$2,161.49, whereas on January 1, 1948, taxpayer was indebted to the corporation for \$6,915.07; and that on January 1, 1947, the corporation was indebted to taxpayer's wife for \$1,711.29, whereas on January 1, 1948, it was indebted to her for only \$120. This also indicates that taxpayers drew upon the corporation for income in 1947.

For 1948, the following year, the corporation's payroll ledger charged taxpayer with the following salary (R. 115-116):

1/2/48....	\$400.	(\$72.90 withheld as taxes, net \$327.10)
1/9/48....	\$400.	(\$72.90 withheld as taxes, net \$327.10)
1/16/48....	\$400.	(\$72.90 withheld as taxes, net \$327.10)
1/31/48....	\$861.90	(no deductions)

For 1948 taxpayer reported he received a salary of \$1,200 from the corporation, yet he attached to his return a Form W-2 showing receipt of total wages of \$2,061.90 and withholding tax of \$206.70. (Ex. E.) As the Tax Court correctly pointed out (R. 64-65):

It is the difference between the \$2,061.90 shown by Form W-2 and the reported \$1,200 which the Commissioner has added to petitioner's taxable 1948 income. We find no adequate explanation whatever in the record for petitioner's faulty reporting and have found that the difference of \$861.20 should have been reported as taxable income in accordance with the Commissioner's determination.

Taxpayers apparently seek to refute the necessary conclusion from the 1947 book entries (Br. 15, R. 222) that the corporation's books "were not in their present condition when he had charge of them," and "that the accountants, Barrow, Wade & Guthrie, performed some really unusual feats of bookkeeping * * *." We submit that the Tax Court correctly disposed of this contention when it held (R. 64) :

We are of the opinion that this testimony in no way destroys the probative value of the corporate books. The accountants who caused the corrections to be made were the same accountants employed by petitioner himself to audit the records at a time when he himself was in control of the corporation. Their competency is in no way impugned by petitioner's testimony and we have no reason for discounting the accuracy of entries as shown on the books.

Further, the accuracy of these entries is evident even from the evidence submitted by taxpayer. Whatever discrepancies may appear to exist between the entries in the corporation's books and the personal records maintained by taxpayer (Ex. 11), they are conceded by taxpayer to have resulted from the fact that (R. 197,

234-236) he recorded only cash receipts which were deposited in his and his wife's bank account. Thus, taxpayers' records did not reflect for 1947 any amounts which were not paid directly to them and were deposited by them. For example, the debit entry of September 30, 1947, of \$5,890 (R. 100-101), which is explained on the corporate books as "to correct errors in cash detail record," is not reflected in taxpayer's records. Taxpayer testified (R. 201) that this represented the proceeds from the sale of furniture and for patent work, admitting that he received a check for \$5,890 from the corporation. The corporation's bill of sale for furniture, however, was dated January 19, 1948, and was in the amount of \$890.67. (Ex. 12.) A credit entry was made to taxpayer's personal account in the corporation's books on January 31, 1948, in the amount of \$890.67 with the explanation "to record purchase of certain furniture under purchase agreement, dated January 19, 1948." (R. 104; Appendix B, *infra*.) In the face of this evidence it appears that taxpayer is mistaken as to the \$5,890 entry, that the sale of furniture actually took place in 1948 and not in 1947, that the sales price of the furniture was \$890.67 and not \$5,890.67, and that taxpayer did not lose any \$5,000 on this transaction, as he alleges. (Br. 14.) It also appears clear that the \$5,890 entry in 1947 reflected cash disbursements to him in that year, and that the corporation's entries were correct.

Taxpayer's records (Ex. 11) also do not reflect any entry for the \$2,600 which he concedes was paid by the corporation to the attorney who defended Holly and which was charged to taxpayer's personal account. (R. 238; Br. 12.) This amount is reflected on the cor-

poration's books as a debit entry for a check payment to taxpayer's personal account of \$2,600 on May 31, 1947, and is explained as a loan from the corporation. (R. 98-99; Appendix B, *infra*). Taxpayer admits (R. 238-239) that he never included this amount in his income, although he claimed it as a deduction in his 1947 return. As the Tax Court correctly held (R. 63-64):

The failure to include this item is typical of petitioner's explanations on this score. He excused it by saying "I certainly haven't got the money. In fact I spent the money. It is gone." This, of course, is no excuse for failing to include amounts as income which came into petitioner's control at a time when the corporation ostensibly could pay them and when the petitioner was in control of the corporate books and for aught that appears of record could have taken down payment directly.

Accordingly, we submit that the Tax Court's decision on this issue is not clearly erroneous and should be sustained by this Court.

C. *The Tax Court was correct in sustaining the Commissioner's determination that taxpayers had understated their long-term capital net gain in 1948 from the sale of their interests in the corporation.*

In January, 1948, taxpayers sold their interests in the corporation pursuant to an option agreement previously executed by them in December, 1947. At issue is the amount of the long-term capital net gain which they received in 1948, and whether this gain can be reported on the installment basis under Section 44(b) of the 1939 Code (Appendix A, *infra*). Taxpayers re-

ported a basis of \$27,624.36 and a sales price of \$41,500, or a long-term net capital gain of \$13,875.64. The Tax Court upheld the Commissioner's determination of a basis of \$20,595.37 and a sales price of \$100,000, or a long-term net capital gain of \$79,504.63. (R. 65-72.)

The Commissioner's adjusted basis of \$20,595.37 was computed as follows (R. 68):

Basis of Patents.....		0
Basis of Stock.....		\$16,349.14
Basis of Real Estate: Cost.....	\$11,991.32	
Less: Depreciation (as adjusted by respondent).....	3,498.86	
	<hr/>	
	\$ 8,492.46	
Petitioners' share thereof (50% of \$8,492.46).....		4,246.23
		<hr/>
		\$20,595.37

An examination of the record supports such a basis as will be seen.

Taxpayer testified (R. 248) that he had acquired his half interest in the patents in exchange for performing services in securing the patents. He did not show that he had ever placed any value upon the patents which he had included in his income. Accordingly, both the Commissioner and the Tax Court were correct in giving a zero basis to the patents.

The \$16,349.14 basis of the stock was determined from the fact that the capital accounts of the four partners as of the date of the transfer of the partnership assets and liabilities to the corporation was \$32,698.28, and at the time of the transfer the corporation credited its capital stock account with \$20,000 and its paid in surplus account with \$12,698.28. (R. 66-67.) Taxpayers do not contest this amount. (Br. 15-16.)

There does not appear to be any controversy as to the \$8,492.46 total basis of the real estate. Taxpayer testified (R. 240-241) that this property was distributed to

the individual partners by the partnership before the partnership was formed, and was then sold by the partners around September 30, 1946, to the corporation for \$11,991.32. Thus, the record supports the basis for the sale property used by the Commissioner and accepted by the Tax Court.

Taxpayers' contention that they had a basis of \$27,-624.36 appears to rest primarily upon their self-serving assertion (Br. 15; R. 172) that they advanced between \$30,000 to \$50,000 to the corporation. No proof was submitted by taxpayer to substantiate this contention except five notes of the partnership totalling \$12,724.36. (Exs. 3, 4, 5, 6, 10.) The Tax Court correctly disposed of this contention as follows (R. 70):

To prove error in the Commissioner's determination, petitioners rely on their self-serving oral testimony to the effect that they advanced from \$36,000 to \$50,000 to the partnership and that these advances should be taken into consideration in computing basis. To corroborate this testimony a series of notes of the partnership to petitioner aggregating some \$12,724.36 dated in 1940 and 1942 were introduced in evidence. One of the notes bore endorsements showing credits of \$6,-211.29. This evidence is inadequate to overcome the correctness of the Commissioner's determination of basis which is supported by other evidence of record. Even if we accept at face value petitioners' oral testimony that they made the claimed advances to the partnership it still seems certain that substantial sums were repaid to them which would reduce the cost of their stock. Their testimony as to these transactions is fragmentary at

best. They have not come forward with evidence which would establish error in the Commissioner's determination of basis, which is sustained.

Support for the Tax Court's holding—that, even if taxpayers made advances to the partnership, substantial amounts thereof were repaid by the corporation—also comes from the subscription agreement and minutes of the corporation's first board meeting and the corporation's books. The subscription agreement and minutes (Exs. 2 and 8) show that the corporation assumed the outstanding liabilities of the partnership (which would include any unpaid loans from taxpayers) in exchange for capital stock of \$20,000 and paid in surplus (which was \$12,698). The corporation's records (R. 85; Appendix B, *infra*) disclose some \$8,122.78 of liabilities owing to taxpayers which were assumed by the corporation on October 1, 1946, and which were later paid off by the corporation. Thus, it appears that all outstanding liabilities were otherwise taken into account when the corporation was formed, and taxpayers should not be entitled to increase their basis for any amounts allegedly advanced by them in prior years to the partnership.

Section 111(b) of the 1939 Code (Appendix A, *infra*) provides as follows:

The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

The Commissioner determined that taxpayers realized \$100,000 from the sale of their interests in the corporation, computed as follows (R. 67-68):

Option payment (made in December 1947).....	\$ 1,000
Cash payment (made in January 1948).....	24,000
Credit to personal account of A. J. Fihe.....	5,000
Face amount of notes and mortgage.....	70,000
	<hr/>
	\$100,000

Taxpayers compute a sales price of \$41,500 by adding the \$24,000 cash payment to the total monthly payments on the notes in 1948 of \$17,500.

There is no doubt but that taxpayer received the \$1,000 option payment (R. 188, Br. 16) although he did not include it in his computation of the sales price. Although this payment was made in December, 1947, when the option was entered into, the \$1,000 was properly includible in the determination of net capital gain for 1948 when the option was exercised and the property was sold. *Aiken v. Commissioner*, 35 F. 2d 620, 624 (C.A. 8th), affirmed on other grounds, 282 U.S. 277.

No controversy exists as to the \$24,000 cash payment made in January, 1948. Also, it is clear that the \$5,000 credit made by the corporation to taxpayer's personal account on January 31, 1948, is properly includible in determining the sale price. Taxpayer was overdrawn in his account with the corporation, i.e., he owed the corporation \$5,000 in January, 1948. The corporation credited this amount to his personal account, with the explanation that this amount was "to record purchase of patent rights, capital stock, and land and buildings from Mr. A. J. Fihe and Elizabeth M. Fihe under option agreement dated December 13, 1947." (R. 104-105; Appendix B, *infra*.) By this action on the part of the corporation taxpayer was relieved from paying \$5,000 to the corporation when his account was closed. Accordingly, this \$5,000 amount is includible in determining his net capital gains (*Winkelman v.*

Commissioner, decided February 20, 1943 (1943 P-H T.C. Memorandum Decisions, par. 43,092)), and taxpayers' contention (Br. 16) that it should not be included because it was never paid to him is without merit.

Thus, the main question is whether the Tax Court was correct in holding that the \$70,000 face amount of the note secured by a chattel mortgage is includible in the sale price, or whether taxpayers are correct in including only the \$17,500 of monthly note payments made in 1948. Taxpayers appear to contend (Br. 16) that the notes had no value (and therefore did not constitute consideration received for the sale property, cf. *Westover v. Smith*, 173 F. 2d 90 (C.A. 9th)) because they were non-negotiable and the chattel mortgage was itself worthless. But non-negotiability is not the same as non-transferability and, as the Tax Court held (R. 71-72), taxpayers have failed to show that the notes lacked value. The question whether they had a fair market value is of course one of fact. *Perry v. Commissioner*, 152 F. 2d 183, 186 (C.A. 8th).

As the Tax Court stated (R. 71), the burden was upon taxpayers to show not only that the secured notes were not worth their face amount but that the notes either had no fair market value or what that value was (see *Owen v. United States*, 8 F. Supp. 707 (C. Cls.)). The record indicates that the notes had value equal to their face amount, since they were given by the corporation in satisfaction of an obligation to pay a fixed amount, were secured, and bore interest. Taxpayers did not introduce the notes,¹⁰ the chattel mortgage or

¹⁰ The taxpayer testified (R. 225) that the notes "are paid and probably destroyed."

any other evidence to show that the value of the chattel mortgage was less than the face amount of the notes, that the property subject to the mortgage was not subject to foreclosure and was not readily saleable for the face amount of the notes, or that the notes were subject to conditions affecting their payment, or that the notes were not transferrable. As a matter of fact, as the Tax Court stated (R. 72), the notes "were paid strictly according to their tenor in a comparatively short time." Thus, the Tax Court did not err in upholding the Commissioner's determination that the face amount of the notes was the proper amount to be used in the computation of taxpayers' long term net capital gains. *Whitlow v. Commissioner*, 82 F. 2d 569 (C. A. 8th).

Taxpayers are not entitled to use the installment method of reporting the gain from the sale of their interests to the corporation. Section 44(b) of the 1939 Code permits a taxpayer to return income on the installment basis if "the initial payments do not exceed 30 per centum of the selling price * * *." The section defines the term "initial payments" to mean "the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made." The statutory provision is clear that the entire payments received in the taxable period are includible in the "initial payments" and that the "selling price" means the total amount involved in the sale and includes cash and other property received by the seller. *Waukesha Malleable Iron Co. v. Commissioner*, 67 F. 2d 368 (C.A. 7th). Here the sale took place in 1948. During 1948 taxpayers received a \$24,000 cash payment

in January, plus monthly payments during the balance of the year in the amount of \$17,500, amounting to "initial payments" of \$41,500. This amount exceeds 30 per centum of the "selling price" of \$100,000.¹¹

Moreover, a taxpayer who desires to use the installment basis of accounting must make an election to do so not later than when he files his return; he cannot make such an election "after expiration of the time within which return is to be made * * *." *Pacific National Co. v. Welch*, 304 U.S. 191; *United States v. Kaplan*, 304 U.S. 195; *Daley v. United States*, 243 F. 2d 466 (C.A. 9th); *Jacobs v. Commissioner*, 224 F. 2d 412, 414 (C.A. 9th). Here, the record does not show that taxpayers ever made such an election. Taxpayer failed to attach any Schedule D to his 1948 return (Ex. E) or otherwise submit sufficient facts to indicate that he had elected to report his capital gains on the installment basis.

Finally, there is no warrant in the statute for permitting a taxpayer, in computing net capital gain upon the sale of a capital asset, to deduct all kinds of expenses which are unrelated to such asset, as taxpayer here seeks to do. (Br. 17-18.) Further, there is even less warrant for permitting such a computation where all of the "expenses" sought to be deducted were disallowed for such reasons as that they were personal expenditures or were unsubstantiated (see Part B

¹¹ If this Court should determine that only part of taxpayers' long-term net capital gain should be reported in 1948, then part of the gain would also be reported in 1949. Under such circumstances we submit that the case should be remanded to the Tax Court, to adjust taxpayer's 1949 net income and to reduce the net operating loss carry-back from 1949 to 1947, which would result in an increased deficiency for 1947. The year 1949 is in issue in this case.

of brief, *supra*). What taxpayers are attempting to do is to trade off their acceptance of the Commissioner's determination of long-term net capital gain for 1948 if this Court would now allow all of the previously disallowed alleged business expenses for 1948 plus the disallowed amount of taxpayers' contributions for that year. The answer, as the Tax Court stated (R. 69), is that: "It is almost axiomatic that such losses are not allowable."

D. *The Tax Court was correct in sustaining the Commissioner's determination that part of the deficiencies for 1946, 1947 and 1948 was due to taxpayers' negligence*

Section 293(a) of the 1949 Code (Appendix A, *infra*) provides, in part, that "If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed * * *." In contrast to the imposition of fraud penalties, the Commissioner does not have the burden of proving negligence. Instead, similar to the determination of a deficiency, the burden is upon a taxpayer to overcome the presumptive correctness of the Commissioner's determination as to negligence. *Boynton v. Pedrick*, 228 F. 2d 745 (C.A. 2d), certiorari denied, 351 U.S. 938, rehearing denied, 351 U.S. 990; *Young v. Commissioner*, 208 F. 2d 795 (C.A. 3d), affirming decision of April 10, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,120). Here the record clearly justifies the Commissioner's imposition of negligence penalties, as the Tax Court found. (R. 72-73.)

Taxpayer has been a practicing attorney for many years and appears to have had considerable business experience. In view of his education and experience taxpayer cannot claim ignorance as any excuse for his multifold disregard of the 1939 Internal Revenue Code.

The Tax Court's finding that part of the deficiencies was due to negligence is clearly supported by the record. First, as we have shown in Part B, *supra*, taxpayer claimed many deductions which were patently not deductible, such as federal income taxes, cost of personal clothing, the expenses of moving his family and personal belongings and of maintaining his family in a hotel, etc. Taxpayer also duplicated several deductions for interest and taxes. Further, many of the claimed deductions were for exaggerated amounts. These actions reflect a negligent attitude on the part of taxpayer. *Beus v. Commissioner*, 28 T. C. 1133.

Second, taxpayer did not disclose sufficient facts to reflect the basis of deductions he claimed. For example, the cost of personal clothing was claimed as a business advertising expense; claimed federal income taxes were not segregated from allowable tax deductions; the cost of moving his family was claimed as freight and travel expenses of his business; and losses incurred in 1948 on the sale of his personal furniture and fixtures were utilized to reduce his long-term net capital gains on the sale of his interests to the corporation, but no Schedule D was attached to the 1948 return (Ex. E), or any other information was appended to the return to explain these deductions. These actions also reflect a negligent attitude by tax-

payer. *Pohlen v. Commissioner*, 165 F. 2d 258 (C.A. 5th).

Third, as taxpayer admits (R. 233), a revenue agent had advised him in 1940 to keep more accurate books with respect to his law practice and in connection with any business with which he might be associated. Apparently taxpayer did not heed this admonition for, as the Tax Court found (R. 72-73), the books and records kept by taxpayer from 1946 through 1949 "were incomplete and did not properly and accurately reflect the taxable income of [taxpayers]." For example, taxpayer was president of the corporation and in charge of its books in 1947. Either he or his wife had to sign or countersign every check disbursed by the corporation. He personally hired an accounting firm to audit the corporation's books and records. He must have checked the entries made by the corporation to his personal account in the corporation's books which charged him and his wife with income and which reflected payment and discharge by the corporation of its obligations to him. Nevertheless he failed to reflect in his personal records or report as income substantial amounts received by him from the corporation which reflected income entries. Also, for 1948, taxpayer had received a Form W-2 withholding statement from the corporation prior to the filing of his return which listed salary paid to him of \$2,061.90 and tax withheld of \$206.70. Nevertheless he reported receiving a salary of only \$1,200 from the corporation, omitting \$861.90, yet taking credit for withholding on this latter amount. These actions also clearly reflect a negligent attitude on his part. *Evans v. Commissioner*, 235 F. 2d 586 (C.A. 8th), certiorari denied, 352 U.S. 909; *Hurley v. Commissioner*, 22 T.C. 1256, affirmed on other issues,

233 F. 2d 177 (C.A. 6th); *Board v. Commissioner*, 51 F. 2d 73 (C.A. 6th), certiorari denied, 284 U.S. 658; *Little v. Helvering*, 75 F. 2d 436 (C.A. 8th); *Sutor v. Commissioner*, 17 T.C. 64.

Taxpayers contend that the Tax Court erred in upholding the Commissioner's assessment of negligence penalties against them on the grounds that their "1946 returns were prepared by a firm of certified public accounts" (Br. 8), that their 1947 returns "reflected absolute concurrence with the Corporation income tax return for the year 1947" (Br. 9), and that for all years they kept complete books and records (Br. 22-23). Taxpayer has not shown that he made full disclosure of all the facts to the accountant in the preparation of his 1946 return. Accordingly, his reliance upon an accountant is misplaced. The contention that his books and records were complete or were in conformity with the corporation's return is clearly refuted by the record. Accordingly, we submit that taxpayers have failed to show that the Tax Court erred in sustaining the Commissioner's imposition of negligence penalties.

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed by this Court.

Respectfully submitted,

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
MELVA M. GRANEY,
KARL SCHMEIDLER,

Attorneys,
Department of Justice,
Washington 25, D. C.

JUNE, 1958.

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. * * *

* * * * *

(c) [As amended by Sec. 202 of the Internal Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

* * * * *

(e) *Losses By Individuals*.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise——

- (1) if incurred in trade or business; or
- (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or
- (3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(1) *Depreciation*.—[As amended by Sec. 121(c) of the Internal Revenue Act of 1942, *supra*.] A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)——

- (1) of property used in the trade or business, or
- (2) of property held for the production of income. * * *

* * * * *

(x) [As added by Sec. 127(a) of the Revenue Act of 1942, *supra*, and amended by Sec. 8(c) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231; and Sec. 304 of the Revenue Act of 1948, c. 168, 62 Stat. 110] *Medical, Dental, Etc., Expenses*.—Expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent specified in section 25(b)(3), to the extent that such expenses exceed 5 per centum of the adjusted gross income.

The deduction shall not be in excess of \$1,250 multiplied by the number of exemptions allowed under section 25(b) for the taxable year (exclusive of exemptions allowed under section 25(b)(1)(B) or (C), with a maximum deduction of \$2,500, except that the maximum deduction shall be \$5,000 in the case of a joint return of husband and wife under section 51(b). * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) [As amended by Sec. 127(b) of the Revenue Act of 1942, *supra*] Personal, living, or family expenses except extraordinary medical expenses deductible under section 23(x);

* * * * *

(26 U.S.C. 1952 ed., Sec. 24.)

SEC. 44. INSTALLMENT BASIS.

* * * * *

(b) *Sales of Realty and Casual Sales of Personality.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning

prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * * *

(26 U.S.C. 1952 ed., Sec. 44.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

(26 U.S.C. 1952 ed., Sec. 111.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) *Negligence.*—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per

centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272(i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

* * * * *

(26 U.S.C. 1952 ed., Sec. 293.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.111-1. *Computation of Gain or Loss.*—Except as otherwise provided, the Internal Revenue Code regards as income or as loss sustained, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 111, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 113(b) and sections 29.113(b)(1)-1 to 29.113(b)(3)-2, inclusive (i.e., the cost or other basis provided by section 113(a), adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the

adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained in the amount of the insufficiency. The basis may be different depending upon whether gain or loss is being computed.

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APPENDIX B

ANALYSIS OF PERSONAL ACCOUNT—A. J. FIHE
PER DEPOSITION OF FRANK H. WISCONS

Record Page	Book Entry Date	Entry	Dr.	Cr.
85	10/1/46	Liability account due.....	\$	\$ 4,661.49
90	11/30/46	Cash disbursement book check 11/1—\$500 and check 11/25/ 46—\$2,000 to Albert J. Fihe..	\$ 2,500.00	
	12/31/46	Balance.....	2,161.49	
			<u>\$ 4,661.49</u>	<u>\$ 4,661.49</u>
	1/1/47	Balance.....		\$ 2,161.49
91	1/31/47	Check 1/10/47 to A. J. Fihe....	\$ 1,000.00	
91	3/31/47	Check 3/17/47 to A. J. Fihe....	800.00	
91	4/30/47	Loan from corporation.....	3,000.00	
92	" " "	Check.....	700.00	
92	" " "	Check.....	700.00	
92	" " "	Check.....	2,325.00	
92	" " "	Proceeds of insurance loans ad- vanced to corporation.....		724.18
87-88	" " "	Executive salaries—accrued but not paid for seven months ended 4/30/47.....		10,706.20
93	" " "	Rent on building for seven months ended 4/30/47.....		140.00
93	" " "	To set up patent installment pay- ments due for seven months ended April 30, 1947.....		5,123.03
94	" " "	No explanation per deposition...	1,199.28	
110-111	" " "	Adjust OAB Tax.....	3.50	
94-95	" " "	To transfer advances to officers to proper accounts.....	350.00	
95	" " "	To charge back unauthorized sal- aries paid to executives in De- cember.....	1,499.50	
95	" " "	Charge Mr. Fihe for items in equipment account.....	563.47	
95-96	" " "	To charge personal accounts for excess payments on taxes with- held.....	86.34	
96	" " "	To charge owners of building for mortgage and interest on same paid by corporation.....	256.25	
96-97	" " "	Interest on officers life insurance loans paid by corporation....	61.58	
97	" " "	To change portion of travelling expenses to respective officers..	705.96	
97-98	" " "	To cancel journal entry relative to patent payments contract for purchase not signed.....	5,123.03	

Record Page	Book Entry Date	Entry	Dr.	Dr.
98-99	5/31/47	Check to A. J. Fihe 5/13/47.....	\$ 2,600.00	
99	6/30/47	Cash.....	2.94	
99	6/30/47	Check.....	3,632.05	
100	9/30/47	Interest on insurance loans to officers concerned.....	34.04	
100-101	" " "	To correct errors in cash detail record.....	5,890.00	
101	" " "	To correct distribution of check No. 8737 charged to Work- men's Comp. Ins. in error on 11/14/46. Insurance agent states that this does not cover a company policy.....	250.00	
101-102	" " "	Patent installment due under contractor for year ended 9/30/47.....		\$ 6,227.21
102		To charge rent on building at \$80 per month for five months ended 9/30/47.....		100.00
102	12/30/47	{ Check 2/5/47 to A. J. Fihe.....	2,292.36	
		{ Royalties scratched out		
103	" " "	To record minimum on royalties.		918.12
103	" " "	To accrue rents under lease arrangement.....		60.00
	12/31/47	Balance.....		6,915.07
			<u>\$33,075.30</u>	<u>\$33,075.30</u>
	1/1/48	Balance.....	\$ 6,915.07	
104	1/31/48	To reverse audit in J.E. #12 dated 4/30/47 applicable to OAB. This was deducted from employees later.....		\$ 42.50
104	" " "	To record purchase of certain furniture under purchase agree- ment dated 1/19/48.....		890.67
104-105	" " "	To close balance in Fihe's accounts charged to A. J. Fihe's salary.....		981.90
105	" " "	To record purchase of patent rights, capital stock, and land and buildings from Mr. A. J. Fihe and Elizabeth M. Fihe under option agreement dated 12/13/47.....		5,000.00
105	2/1/48	Balance.....	-0-	-0-
			<u>\$ 6,915.07</u>	<u>\$ 6,915.07</u>

ANALYSIS OF PERSONAL ACCOUNT—ELIZABETH FIHE PER DEPOSITION OF FRANK H. WISCONS

Record Page	Book Entry Date	Entry	Dr.	Cr.
85,105	10/1/46	Credit balance in account.....		\$ 3,461.29
105-107	10/31/46	Checks to various individuals charged to Mrs. Fihe's account \$	300.00	
107-108	11/30/46	Checks to various individuals charged to Mrs. Fihe's account	750.00	
108	" " "	Check 11/18/46 to Mrs. Fihe....	700.00	
	" " "	Balance.....	1,711.29	
			<u>\$3,461.29</u>	<u>\$3,461.29</u>
	1/1/47	Balance.....		\$1,711.29
109	1/31/47	Check 1/10/47 to Mrs. Fihe.....	\$ 800.00	
109	3/31/47	Check 3/21/47 to Mrs. Fihe.....	550.00	
110	4/30/47	Check 3/21/47 to Mr. Fihe....	300.00	
110	" " "	To adjust salaries upon which tax has been paid and not deducted	449.75	
110-111	" " "	Adjust OAB tax.....	1.75	
96,111	" " "	To charge owners of building for mortgage and interest on same paid by corporation.....	256.25	
111-112	" " "	To transfer advances to officers to proper account.....		875.00
111-112	" " "	Rent on building for seven months ended 4/30/47.....		140.00
112-113	6/30/47	Check 6/20/47 to Mrs. Fihe.....	408.54	
113	9/30/47	Rent on building.....		100.00
113-114	12/30/47	Rent on building.....		60.00
	12/31/47	Balance.....	120.00	
			<u>\$2,886.29</u>	<u>\$2,886.29</u>
	1/1/48	Balance.....		\$ 120.00
114	1/31/48	To close balance of Mrs. A. J. Fihe's account charged to A. J. Fihe's salary.....	\$ 120.00	
	2/1/48	Balance.....	-0-	-0-
			<u>\$ 120.00</u>	<u>\$ 120.00</u>

No. 15726

United States
Court of Appeals
for the Ninth Circuit

ALBERT J. FIHE and ELIZABETH FIHE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax
Court of the United States

FILED

MAR 12 1958

PAUL P. O'BRIEN, CLERK

No. 15726

United States
Court of Appeals
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ALBERT J. FIHE and ELIZABETH FIHE,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 52394

ALBERT J. FIHE,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Regional Commissioner of Internal Revenue in his notice of deficiency dated January 14, 1954, the first paragraph of which states as follows:

“You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946, discloses a deficiency of \$9,515.06 and penalty of \$475.75, as shown in the attached statement.”

And as a basis of his proceedings, alleges as follows:—

I.

The petitioner is an individual, is married and resides with his wife at 1671 Casale Road, Pacific Palisades, California, and that the above address is his residence. The return for the period here involved was filed with the Collector of Internal Revenue in Chicago, Illinois.

II.

The notice of deficiency, a copy of which is at-

tached and marked "Exhibit A", was mailed to the petitioner on January 14, 1954.

III.

The determination of tax for the year 1946 set forth on the said notice of deficiency is erroneous, for the following reasons:—

(a) The Commissioner erred in finding a net income for the year 1946 instead of a loss and erred in reversing the petitioner's claim for a refund of \$1,633.56.

(b) The Commissioner erred in increasing my distributive share of income from the partnership known as Holly Molding Devices, Inc., of Chicago, Illinois, in the amount of \$13,663.34, and in holding that my wife, Elizabeth M. Fihe was not a bona fide member of said partnership during the year 1946. However, I hereby declare that there was a true partnership from the beginning of the organization, that we both invested considerable sums of money, totalling more than \$35,000.00, in Holly Molding Devices, a partnership of Chicago, Illinois, during the period from 1938 to 1946 inclusive. My wife assisted in organizing the partnership, contributed money to its organization and in its subsequent development, worked at the offices of the partnership assisting in the keeping of books and records, signing of checks, taking part in conferences relating to the conduct of the business and attended sales meetings, displays and shows advertising the products of the company in

many cities throughout the country. At these shows and conventions, she distributed literature, talked to prospective customers, assisted in explaining the construction and operation of the machines, took orders, saw that the orders were filled and in general, performed the duties of an active and bona fide partner in the business. She can therefore qualify better, in all respects, as an active bona fide partner than Agnes Holly, the wife of Harry H. Holly who was also a partner, but who contributed no money whatsoever and worked at the offices of the company only during the time that her husband was serving a sentence in the Federal Penitentiary for income tax fraud, which fraud was discovered and voluntarily reported by me to the Collector of Internal Revenue immediately after its inception, and I assisted internal revenue agents and the Federal Bureau of Investigation in trapping said Harry H. Holly, an internal revenue agent and the accountant for the company in a conspiracy to defraud the United States Government of considerable sums of income taxes for the years 1944, 1945 and 1946.

(c) The Commissioner erred in disallowing deductions in the amount of \$5,015.58 for alleged overstated legal expense and a loss from operation of the Los Angeles office.

There is a mention in this allegation of unauthorized deduction of \$1,000.00 included in legal expense and stated as paid to deceased partner's wife. So far as petitioner is advised, none of the

members of the original partnership are deceased, so this is obviously in error.

(d) There is no basis for transferring the personal exemption credit as originally claimed by my wife and myself in our separate returns.

(e) Protest is made against the recommendation of a penalty for negligence. My records are perfectly intelligible, absolutely accurate, readily understandable, and the fact that certain of these records were lost in the transfer of all my business and my residence belongings from Illinois to California is obviously not my fault.

Wherefore, petitioner prays that this court may hear this proceeding and determine that there is no deficiency in petitioner's income tax liability for the year 1946.

/s/ ALBERT J. FIHE,

Pro se and Attorney.

Duly Verified.

EXHIBIT "A"

U. S. Treasury Department—Office of the Regional
Commissioner, Internal Revenue Service, 1250
Subway Terminal Building, 417 South Hill
Street, Los Angeles 13, California.

In Replying Refer to: ARC-Ap:SF — LA:COP:
RR — 90-D.

Mr. Albert J. Fihe
1023 Victory Place,
Burbank, California.

January 14, 1954

Dear Mr. Fihe:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946 discloses a deficiency of \$9,515.06 and penalty of \$475.75, as shown in the attached statement.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency and penalty mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute, in duplicate, the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and penalty and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner of Internal Revenue,

By W. T. TIGNER,

Associate Chief, Appellate Div.

Enclosures:

Statement

Form 1276

Agreement Form

STATEMENT

Mr. Albert J. Fihe

1023 Victory Place, Burbank, California

Tax Liability for the Taxable Year Ended December 31, 1946:

Year	Deficiency	5% Penalty
1946—Income tax	\$9,515.06	\$475.75

In making this determination of your income tax and penalty liabilities careful consideration has been given to the report of examination dated January 3, 1951, to your protest dated January 24, 1951 and to conferences held on various dates from May 16, 1951 to September 1, 1953.

The 5% negligence penalty is asserted under the provisions of section 293(a) of the Internal Revenue Code.

ADJUSTMENTS TO NET INCOME

Year 1946

Net income disclosed by original return.....	\$ 2,508.32
Add: Additional income reported on amended return....	5,994.32
<hr/>	
Net income per amended return.....	\$ 8,502.64
Deduct: Tentative net operating loss deduction (carry-back from year 1948).....	8,502.64
<hr/>	
Net income previously determined.....	\$ 0.00
Unallowable deductions and additional income:	
(a) Net operating loss deduction	
disallowed	\$ 8,502.64
(b) Partnership income—transferred	
from wife's return.....	13,663.34
(c) Business income increased.....	5,015.58
<hr/>	
	27,181.56
<hr/>	
Net income as adjusted.....	\$27,181.56

EXPLANATION OF ADJUSTMENTS

(a) Tentative net operating loss deduction (carry-back from the year 1948) is restored to income since, upon examination, there is disclosed net income for the taxable year 1948 rather than a net loss of \$27,122.41 shown on the joint 1948 return. (Tentative refund of \$1,633.56 income tax allowed is, therefore, reversed.)

(b) Your distributive share of income from the partnership Holly Molding Devices, Chicago, Illinois, for the taxable year January 1, 1946 to September 30, 1946, date of dissolution, is increased as follows:

Your corrected share of distributive income from
the partnership \$27,326.69

Less:

Amount reported on original return.... \$5,940.61

Amount reported on amended return

 filed 7-7-1947 7,722.74 13,663.35

(1) Adjustment—increase \$13,663.34

(1) The amount of \$13,663.34 was reported on the amended return of your wife, Mrs. Elizabeth M. Fihe, as her distributive share of partnership income.

Explanation of Adjustments—(Continued)

It is held that your wife, Mrs. Elizabeth M. Fihe, was not a bona fide member of said partnership during the taxable year 1946. Accordingly, the portion of partnership income reported on her amended 1946 return in the amount of \$13,633.34 is included as a part of your distributive share of partnership income.

(c) The understatement of business income in your 1946 return is determined as follows:

(1) Deduction for legal expenses overstated.....	\$1,000.00
(2) Deduction for traveling expense overstated.....	1,537.47
(3) Unreported income—Los Angeles office.....	749.69
	<hr/>
Total	\$3,287.16
(4) Loss, Los Angeles office, claimed on amended return disallowed	1,728.42
	<hr/>
Adjustment—increase in business income.....	\$5,015.58

(1) The item of \$1,000.00 (included in \$5,720.30 legal expense claimed) for payment to deceased partner's wife is not an allowable deduction.

(2) The amount of \$1,537.47 (included in traveling expense of \$4,763.77 claimed) is disallowed as representing personal items.

(3) and (4) There is disclosed net income of \$749.69 from the operation of your Los Angeles office instead of a loss of \$1,728.42 claimed on the amended return.

(d) Personal exemption credit for three dependents is transferred to your return from the return of your wife. The total credit allowed is, therefore, \$2,000.00 in lieu of \$500.00 claimed on your return.

COMPUTATION OF TAX

Year 1946

Net income	\$27,181.56
Less: (d) Exemptions (4).....	2,000.00
	<hr/>
Balance subject to tax.....	\$25,181.56
Tentative tax	\$10,257.12
Less: 5% reduction.....	512.86
	<hr/>
Income tax liability.....	\$ 9,744.26

Computation of Tax—(Continued)

Income tax disclosed by return:

Original, Account No. 2085379

Chicago District \$ 399.68

Amended return, 4-300828-1948..... 1,463.08

Total \$1,862.76

Less: Tentative allowance IT-CB-23947..... 1,633.56 229.20

Deficiency of income tax..... \$ 9,515.06

5% negligence penalty..... \$ 475.75

[Endorsed]: T.C.U.S. Filed April 8, 1954.

The Tax Court of the United States

Docket No. 52396

ALBERT J. FIHE and ELIZABETH M. FIHE,
Husband and Wife, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Regional Commissioner of Internal Revenue in his notice of deficiency dated January 14, 1954, the first paragraph of which states as follows:

“You are advised that the determination of your income tax liabilities for the taxable years ended December 31, 1947, and December 31, 1948, discloses a deficiency of \$7,324.10 and penalty of \$880.12, as shown in the attached

statement.” (No mention was made of the year 1949, but the determination included a resume of that year.)

And as a basis of their proceedings, allege as follows:

I.

The petitioners are individuals, are married and are living together, both residing at 1671 Casale Road, Pacific Palisades, California, and that the above address is their joint residence. The return for the year 1947 was filed with the Collector of Internal Revenue in Chicago, Illinois, and the returns for the years 1948 and 1949 were filed with the Collector of Internal Revenue in Los Angeles, California.

II.

The notice of deficiency, a copy of which is attached hereto and marked “Exhibit A”, was mailed to the petitioners on January 14, 1954.

III.

For the Year 1947

The determination of tax for the year 1947 set forth on the said notice of deficiency is erroneous.

The Commissioner, in recalculating our return, increased our net income for the year by the sum of \$893.50. This was in error, as follows:—

(a) We did not receive taxable or any other dividends from Holly Molding Devices, Inc., of Chicago, Illinois, during the year 1947, in the amount of \$8,890.00 or in any other amount.

(b) We did not receive royalties of \$1,166.57 in

the year 1947 from Holly Molding Devices, Inc. All royalties received were fully reported, and were from Milprint, Inc., of Milwaukee, Wisconsin.

(c) Disallowance of contributions in the amount of \$92.00 is arbitrary.

(d) Disallowance of \$6,283.38 as taxes paid in the year 1947 is erroneous.

(e) Disallowance of medical expenses deduction of \$19.17 is arbitrary, capricious, unrealistic, contrary to the actual facts, and is a good illustration of the attitude of various examiners in this matter.

(f) The mathematical error of \$64.09 in totalling our listed deductions is admitted without prejudice to any claim for deductions in this corrected total.

(g) The correction of the capital loss on Rio Grande Copper Co. stock is admitted.

(h) The Commissioner's computation of a claimed loss in business income is incorrect in that all legal expenses deducted were properly substantiated, also travelling expenses and advertising expenses were properly substantiated. The gross receipts were not understated in the amount of \$943.22.

(i) The credit for three dependents instead of two is admitted.

(j) Petitioners further allege that Elizabeth M. Fihe was an actual partner in the firm known as Holly Molding Devices of Chicago before the same was incorporated. The findings of various agents and other reviewing officers have all been to the effect that no true partnership existed. However, your petitioners hereby declare that there was a true partnership from the beginning of the organi-

zation, that they both invested considerable sums of money, totalling more than \$35,000.00, in Holly Molding Devices, a partnership of Chicago, Illinois, during the period from 1938 to 1946 inclusive. Elizabeth M. Fihe assisted in organizing the partnership, contributed money to its organization and in its subsequent development, worked at the offices of the partnership assisting in the keeping of books and records, signing of checks, taking part in conferences relating to the conduct of the business and attended sales meetings, displays and shows advertising the products of the company in many cities throughout the country. At these shows and conventions, she distributed literature, talked to prospective customers, assisted in explaining the construction and operation of the machines, took orders, saw that the orders were filled and in general, performed the duties of an active and bona fide partner in the business. She can therefore qualify better, in all respects, as an active bona fide partner than Agnes Holly, the wife of Harry H. Holly who was also a partner, but who contributed no money whatsoever and worked at the offices of the company only during the time that her husband was serving a sentence in the Federal Penitentiary for income tax fraud, which fraud was discovered and voluntarily reported to the Collector of Internal Revenue in Chicago immediately after its inception, by Albert J. Fihe, who assisted internal revenue agents and the Federal Bureau of Investigation in trapping said Harry H. Holly, an internal revenue agent and the

accountant for the company in a conspiracy to defraud the United States Government of considerable sums of income taxes for the years 1944, 1945 and 1946.

(k) Petitioners further aver that any and all penalties arbitrarily assessed against them during the progress of the above determinations were unfair, unfounded and are null and void.

IV.

For the Year 1948

The determination of tax for the year 1948 set forth on the said notice of deficiency is erroneous, as follows:—

(a) The salary income received by Albert J. Fihe from Holly Molding Devices, Inc., for the year 1948 was not understated in the sum of \$861.90 or in any other sum.

(b) The disallowance of sundry amounts as unsubstantiated, under the headings of Interest, Taxes, Losses, Freight expense, Legal expense, Stationery, Travelling expense, Commissions, Advertising, Repairs, Postage, Telephone and Depreciation is arbitrary, unreasonable and in absolute error.

(c) The disallowance of certain contributions reported by your petitioners is wrong.

(d) The Commissioner was in error when disallowing losses on sales of residences and furniture due to removal of business and residence from Illinois to California. The Commissioner erred in

computing the long term capital gain and the sale of stock of Holly Molding Devices, Inc. He erred in arbitrarily assuming that the cost of the stock was approximately \$20,000.00, when in fact it was over \$35,000.00. The examiner further arbitrarily assessed the entire receipt for the sale of our interest in Holly Molding Devices, Inc., onto the year 1948. We received approximately \$100,000.00 for the sale of our interests in said corporation, but only \$25,000.00 of this was paid in cash, the remainder being secured by a mortgage note on the corporation properties and payable in monthly instalments of \$1,750.00. We reported these sums as received in 1948 and succeeding years, and should not be taxed with the entire amount in a single year when the total was not collected until several years later. Furthermore, the mortgage notes deliberately omitted the words "or order" after our names as payees, thereby making these notes non-transferable. The fact that said notes were non-transferable and non-negotiable eliminates any possibility of a tax payment on the full amount of the sale until such time as the actual amounts of the notes had been collected by us. These non-negotiable promissory notes must be considered as having no fair market value.

(e) The casualty loss deduction of \$2,300.04 was fully substantiated. We were forced to file several suits against the parties responsible for the damage to our property. Some of these suits have not yet come to trial, and in the one that did, we obtained nothing.

(f) The disallowance of medical expenses is improper and arbitrary.

(g) The computation of the tax for the year 1948 is completely wrong as stated above, and the 5% negligence penalty is entirely unwarranted. There was no negligence.

V.

For the Year 1949

The calculation of an increase in business income for the year 1949 is erroneous, as follows:

(a) The Commissioner erred in arbitrarily disallowing deductions in the amount of \$10,873.60 under the headings of Repairs, Advertising, Legal expense, Travelling expense, Interest, Postage, Telecast, Bandmaster and Depreciation.

(b) The Commissioner erred in disallowing contributions in the amount of \$238.00, which amount was fully substantiated.

(c) The disallowance of interest deduction as a duplication is correct.

(d) The disallowance of taxes as a duplication is correct.

(e) The amount of \$21,000.00 representing deferred payments received from Holly Molding Devices, Inc., on sale of capital stock should not have been transferred back to 1948 income, but should have been considered as a long term capital gain in 1949 and handled as such.

VI.

Our claim for refund on account of carry back

losses was proper, is substantiated by our returns as filed, and protest is hereby made against any attempted disallowance of such refund or any attempt to make us return the same.

Wherefore, petitioners pray that this court may hear this proceeding and determine that there is no deficiency in petitioners' income tax liability for the years 1947, 1948 and 1949.

Elizabeth M. Fihe hereby appoints Albert J. Fihe her attorney with full powers in the premises.

/s/ ELIZABETH M. FIHE,

/s/ ALBERT J. FIHE,

Pro se and Attorney.

Duly Verified.

EXHIBIT "A"

U. S. Treasury Department, Office of the Regional
Commissioner, Internal Revenue Service, 1250
Subway Terminal Building, 417 South Hill
Street, Los Angeles 13, California.

In Replying Refer To: ARC-Ap:SF LA:COP:RR
90-D.

January 14, 1954.

Mr. Albert J. Fihe and
Mrs. Elizabeth M. Fihe,
Husband and Wife,
1023 Victory Place,
Burbank, California.

Dear Mr. & Mrs. Fihe:

You are advised that the determination of your

income tax liabilities for the taxable years ended December 31, 1947, and December 31, 1948, discloses a deficiency of \$7,324.10 and penalty of \$880.12, as shown in the attached statement.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency and penalty mentioned.

Within 90 days from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days, you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute, in duplicate, the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency and penalty and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner of Internal Revenue,

By W. T. TIGNER,

Associate Chief, Appellate Div.

Enclosures:

Statement

Form 1276

Agreement Form

STATEMENT

Mr. Albert J. Fihe and Mrs. Elizabeth M. Fihe, Husband and Wife
1023 Victory Place, Burbank, California
Tax Liability for the Taxable Years Ended
December 31, 1947 and December 31, 1948

Year	Deficiency	5% Penalty
1947—Income Tax.....	\$ 397.40	\$533.78
1948—Income Tax.....	6,926.70	346.34
Total	<u>\$7,324.10</u>	<u>\$880.12</u>

In making this determination of your income tax and penalty liabilities careful consideration has been given to the report of examination dated January 3, 1951, to your protest dated January 24, 1951, to conferences held on various dates from May 16, 1951 to September 1, 1953 and to your claim for refund of \$1,725.43 income tax for the taxable year 1947 filed on August 25, 1950.

Your claim is based upon the statement that "losses from the year 1949 more than offset the entire sum paid on the joint return for 1947." The amount of net operating loss deduction allowable has been determined herein, however, adjustment of other items disclose a deficiency in tax and your claim is therefore, not allowable.

If a petition to The Tax Court of the United States is filed against the deficiency shown herein, the issue set forth in your claim for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with internal revenue laws relating to the disallowance of claims.

The 5 per cent negligence penalty is asserted under the provisions of section 293(a) of the Internal Revenue Code.

ADJUSTMENTS TO NET INCOME

Year 1947

Net income disclosed by return.....		\$10,791.27
Unallowable deductions and additional income:		
(a) Dividends	\$ 8,890.00	
(b) Royalties	1,166.57	
(c) Contributions disallowed	92.00	
(d) Taxes disallowed	6,283.38	
(e) Medical expense disallowed.....	19.17	
(f) Mathematical error	64.09	16,515.21
	<hr/>	<hr/>
Total		\$27,306.48
Additional deductions		
(g) Capital loss	\$ 406.82	
(h) Business loss—net operating loss deduction	15,214.89	15,621.71
	<hr/>	<hr/>
Net income as adjusted.....		\$11,684.77

EXPLANATION OF ADJUSTMENTS

(a) It has been determined that you received taxable dividends from Holly Molding Devices, Inc., during the year 1947 in the amount of \$8,890.00, which amount was not reported in your income tax return.

(b) It has been determined that you received royalties of \$1,166.57 in the year 1947, which amount was not reported in your income tax return.

(c) Deduction for contributions is reduced by \$92.00 (\$448.15 claimed on the return less \$356.15, amount substantiated).

(d) The deduction for taxes paid was overstated in your return for the year 1947 by the amount of \$6,283.38, determined as follows:

Amount claimed on return.....	\$7,680.88
Amount substantiated as taxes paid in the year.....	1,397.50
	<hr/>
Amount disallowed	\$6,283.38

(e) Medical expense deduction of \$19.17 claimed on the return is disallowed. The amount of \$1,028.27 medical expense paid shown on the return has not been substantiated.

Explanation of Adjustments—(Continued)

(f) Deductions listed on page 3 of your return amount to \$10,327.49 instead of \$10,391.58 claimed, indicating a mathematical error of \$64.09.

(g) Capital loss on Rio Grande Copper Co. stock is allowed as follows:

Cost, 1-26-1946		\$ 1,000.00
Liquidating dividend received.....		186.37
		<hr/>
Long-term capital loss.....	\$	813.63
50% loss recognized.....	\$	406.82
Amount claimed on return.....		0.00
		<hr/>
Capital loss deduction allowed.....	\$	406.82
(h) Business income (loss) reported on return.....		\$(3,151.10)
Increase:		
Deduction for legal expense		
disallowed as unsubstantiated.....	\$2,600.00	
Deduction of business traveling		
expense overstated	1,447.95	
Advertising expense overstated		
(personal items)	555.00	
Gross receipts understated.....	943.22	5,546.17
	<hr/>	<hr/>
Business income for the taxable year....	\$	2,395.07
Less: Net operating loss deduction		
allowed (per Exhibit A, attached).....		20,761.06
		<hr/>
Business income (loss) as adjusted.....		\$(18,365.99)
Business loss claimed on return.....		(3,151.10)
		<hr/>
Adjustment—decrease in net income.....	\$	15,214.89

(i) In the computation of tax, credit of \$1,500.00 is allowed for 3 exemptions (husband, wife and daughter) in lieu of the amount of \$1,000.00 claimed on the return.

COMPUTATION OF TAX

Year 1947

Net income	\$11,684.77
Less: (i) Exemptions—3.....	1,500.00
Balance subject to tax.....	<u>\$10,184.77</u>
Tentative tax	\$ 2,710.21
Less: 5% reduction.....	135.51
Income tax liability.....	<u>\$ 2,574.70</u>
Income tax disclosed by return: Original, Account No. 3006769, Chicago District.....	\$2,440.58
Less: Tentative allowance IT-CB 28826.....	263.28
	<u>2,177.30</u>
Deficiency of income tax.....	\$ 397.40
5% negligence penalty (as computed below).....	\$ 533.78

COMPUTATION OF PENALTY

Year 1947

Net income	\$11,684.77
Add: Net operating loss deduction.....	20,761.06
Net income before net operating loss deduction.....	<u>\$32,445.83</u>
Less: Exemption	1,500.00
Balance subject to tax.....	<u>\$32,945.83</u>
Tentative tax	\$13,806.41
Less: 5% reduction.....	690.32
Income tax liability before net operating loss carry- back from year 1949.....	<u>\$13,116.09</u>
Income tax liability reported on return.....	2,440.58
Deficiency of income tax for purpose of penalty com- putation	<u>\$10,675.51</u>
5% negligence penalty.....	\$ 533.78

ADJUSTMENTS TO NET INCOME

Year 1948

Net income (loss) disclosed by return..... \$(27,122.41)

Unallowable deductions and additional income:

(a) Additional salary income.....	\$ 861.90	
(b) Business income	16,387.10	
(c) Contributions disallowed	373.23	
(d) Capital gain	34,507.75	
(e) Casualty loss	2,300.04	
(f) Medical expense	1,089.34	55,519.36

Net income as adjusted.....		\$ 28,396.95
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EXPLANATION OF ADJUSTMENTS

(a) It has been determined that the salary income reported in the return for the year 1948 as received from Holly Molding Devices, Inc., was understated in the sum of \$861.90, as shown below:

Amount received as shown by the	
corporate records	\$ 2,061.90
Amount reported in return.....	1,200.00

Additional salary income.....	\$ 861.90
-------------------------------	-----------

(b) It has been determined that net income from business was understated in the return for the year 1948 by the sum of \$16,387.10, due to the following adjustments:

Deductions disallowed:

Interest (unsubstantiated)	\$ 235.40
Taxes (unsubstantiated)	511.29
Losses (unsubstantiated)	3,362.44
Freight expense (personal items).....	1,124.45
Legal expense (unsubstantiated).....	561.75
Stationery (unsubstantiated)	150.00
Traveling expense (personal items).....	5,802.97
Commissions (personal items).....	800.00
Advertising (personal expense).....	598.14
Repairs (duplication)	74.57
Postage (duplication)	243.33
Telephone (duplication)	71.53
(1) Depreciation	1,986.58

Total Deductions disallowed.....	\$ 15,522.45
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Explanation of Adjustments—(Continued)

Add: Error in addition of deductions on return

(Correct total \$52,864.27 in lieu of \$53,448.47

shown on the return)..... 584.20

Unreported receipts 280.45

Adjustment—increase in business income..... \$ 16,387.10

Business income (loss) shown on return..... \$(33,363.88)

Increase from above..... 16,387.10

Business income (loss) as adjusted..... \$(16,976.78)

(1) Depreciation deduction is disallowed in the amount of \$1,-986.58, as shown below:

	Basis	%	Depreciation
Machinery	\$10,270.58	10%	\$ 1,027.06
Building	17,000.00	3%	510.00
Total			\$ 1,537.06
Depreciation allowed for 6 months.....			\$ 768.53
Amount claimed on return.....			2,755.11
Depreciation disallowed			\$ 1,986.58

(c) Deduction for contributions is reduced by \$373.23 (\$664.48 claimed on the return less \$291.25, amount substantiated).

(d) You reported net capital gain of \$5,194.56 on your return, as follows:

"Sale of Holly Molding Devices.....	Gain	\$ 13,875.64
Sale of Apt. & Furniture.....	Loss	1,130.48
Sale of House & Furniture.....	Loss	18,550.60
Net gain		5,194.56"

Losses on sales of personal residences and personal furniture are not allowable deductions for income tax purposes.

Long-term capital gain on the sale of capital stock of Holly Molding Devices, Inc., is computed as follows:

Selling price	\$100,000.00
Cost basis of stock.....	20,595.37
Long-term capital gain.....	\$ 79,404.63

Explanation of Adjustments—(Continued)

Gain recognized—50% (section 117, Internal Revenue Code).....	\$ 39,702.31
Total capital gain as adjusted.....	<u>\$ 39,702.31</u>
Amount reported on return.....	5,194.56
Adjustment—increase in capital gain.....	<u>\$ 34,507.75</u>

(e) The casualty loss deduction in the 1948 return in the amount of \$2,300.04 has not been substantiated as an allowable deduction from gross income under the provisions of section 23 of the Internal Revenue Code.

(f) Deduction for medical expense is disallowed, as shown below:

Medical expense deduction claimed on return.....	\$ 1,089.34
Medical expense paid—amount substantiated.....	\$ 735.79
Adjusted gross income as revised.....	\$29,162.99
5% of adjusted gross income.....	1,458.15
Excess	None
Medical expenses allowable.....	\$ 0.00
Amount claimed	1,089.34
Medical expense disallowed.....	<u>\$ 1,089.34</u>

COMPUTATION OF TAX

Year 1948

	Alternative Tax	Tax at Ord- inary Rates
Net income	\$28,396.95	\$28,396.95
Less: Exemptions—3.....	1,800.00	1,800.00
Income subject to tax—joint.....	<u>\$26,596.95</u>	<u>\$26,596.95</u>
1/2 thereof	\$13,298.48	\$13,298.48
Less: Long-term capital gain.. \$39,702.31		
1/2 thereof	19,851.15	19,851.15
Ordinary income	<u>\$ 0.00</u>	<u>\$13,298.48</u>
Tentative tax	\$ 0.00	\$ 3,958.35

Computation of Tax—(Continued)

	Alternative Tax	Tax at Ordinary Rates
Less % reduction:		
\$ 400.00 at 17%.....	\$ 68.00	
3,558.35 at 12%.....	427.00	495.00
Partial tax	\$ 0.00	
Add: 50% of \$19,851.15.....	9,925.58	
Alternative tax—single computation.....	\$ 9,925.58	
Alternative tax—joint (not applicable)....	\$19,851.16	
Tax at ordinary rates—single computation.....		\$ 3,463.35
Tax at ordinary rates—joint (lesser tax).....		\$ 6,926.70
Income tax liability.....		\$ 6,926.70
Income tax disclosed by return:		
Original, Account No. 9143618, Los Angeles District		0.00
Deficiency of income tax.....		\$ 6,926.70
5% negligence penalty.....		\$ 346.34

EXHIBIT "A"

NET OPERATING LOSS DEDUCTION FOR YEAR 1947

Net loss for year 1949 (as shown below).....	\$20,884.54
Addition under section 122 (d) I.R.C.:	
Long-term capital gain taken into account 100%—	
Amount included in income, \$123.48—Balance.....	123.48
Net operating loss deduction—for year 1947.....	\$20,761.06

Year 1949

ADJUSTMENTS TO NET INCOME

Net income (loss) disclosed by return.....	\$(18,146.31)
Increase:	
(a) Business income	\$10,602.38
(b) Contributions	238.00
(c) Interest	3,909.95
(d) Taxes	3,511.44
	18,261.77
Total	\$ 115.46
Decrease:	
(e) Payments reported from corporation.....	21,000.00
Net income (loss) as adjusted.....	\$(20,884.54)

EXPLANATION OF ADJUSTMENTS

(a) Business income reported on the 1949 return is increased by \$10,602.38, due to the following adjustments:

Deductions disallowed:

Repairs (personal items \$1,906.02 and personal auto repairs \$204.00).....	\$ 2,110.02
Advertising (personal items \$884.57 and duplication \$1,797.09)	2,681.66
Legal expense (duplication).....	247.40
Traveling expense (personal items \$1,752.99 and duplication \$230.18)	1,983.17
Interest expense (personal item).....	601.06
Postage expense (personal item).....	249.00
Telecast expense (duplication).....	1,661.62
Bandmaster (duplication)	632.50
(1) Depreciation	707.17
Total deductions disallowed.....	\$10,873.60
Receipts understated	628.78
Total	\$11,502.38
Less: Mathematical errors.....	900.00
Net increase in business income.....	\$10,602.38

(1) Depreciation is adjusted as follows:

	Basis	%	Allowed	Claimed on Return
Machinery—	\$10,270.58	10%	\$1,027.06)	
1949 Additions	5,223.43	10%	6 mo. 261.17)	\$1,550.40
Building—	17,000.00	3%	510.00)	
1949 Additions	3,000.00	3%	6 mo. 45.00)	1,000.00
Total			\$1,843.23	\$2,550.40
				1,843.23

Depreciation disallowed \$ 707.17

(b) Deduction for contributions is disallowed in the amount of \$238.00 (\$285.51 claimed on return less \$47.51, amount substantiated).

(c) Interest deduction of \$3,909.95 is disallowed as a duplication. The amount was also claimed as a business expense.

Explanation of Adjustments—Continued)

(d) Deduction for taxes is disallowed as a duplication. The amount was also claimed as a business expense.

(e) The amount of \$21,000.00 representing payment received from Holly Molding Devices, Inc., is eliminated from income. The amount is included in 1948 income in the computation of capital gain from sale of patent interests, etc. to Holly Molding Devices, Inc.

[Endorsed]: T.C.U.S. Filed April 8, 1954.

[Title of Tax Court and Docket No. 52394.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I.

For lack of sufficient information, denies that the petitioner resides at 1671 Casale Road, Pacific Palisades, California; admits the remaining allegations contained in paragraph I of the petition.

II.

Admits the allegations contained in paragraph II of the petition.

III.

Denies the allegations of error contained in paragraph III of the petition, and all subparagraphs thereof.

IV.

Denies generally and specifically each and every allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination be approved.

/s/ DANIEL A. TAYLOR, REM,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel;
E. C. Crouter, Assistant Regional Counsel;
R. E. Maiden, Jr., Special Assistant to the Regional Counsel; John J. Burke, Special Attorney; Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed May 17, 1954.

[Title of Tax Court and Docket No. 52396.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits and denies as follows:

I.

For lack of sufficient information, denies that the petitioners reside at 1671 Casale Road, Pacific Palisades, California; admits the remaining allegations contained in paragraph I of the petition.

II.

Admits the allegations contained in paragraph II of the petition.

III.

Denies the allegations of error contained in paragraph III of the petition, and all subparagraphs thereof.

IV.

Denies the allegations of error contained in paragraph IV of the petition, and all subparagraphs thereof.

V.

Denies the allegations of error contained in paragraph V of the petition, and all subparagraphs thereof.

VI.

Denies the allegations contained in paragraph VI of the petition.

VII.

Denies generally and specifically each and every allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination be approved.

/s/ DANIEL A. TAYLOR, REM,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel;
E. C. Crouter, Assistant Regional Counsel;
R. E. Maiden, Jr., Special Assistant to the Regional Counsel; John J. Burke, Special Attorney; Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed May 17, 1954.

[Title of Tax Court and Docket No. 52396.]

AMENDMENT TO ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for further answer to the petition in the above-entitled proceeding, alleges as follows:

VIII.

In 1948 petitioners sold their capital stock, certain patent rights and all their interests in certain land and buildings to the Holly Molding Devices, Inc. Respondent determined that this sale was a completed sale in 1948 and that the gain therefrom should be reported in 1948 as long term capital gain. Petitioners reported a portion of this gain in 1948 and another portion in 1949. Respondent, following his determination that the sale was completed in 1948, eliminated from the petitioners' income of 1949 the portion of the gain from the sale which they had reported in 1949. This elimination from 1949 income resulted in a net operating loss for such year which was carried back to 1947, as set forth in the notice of deficiency.

Petitioners contend they are entitled to report the gain from such sale on the installment method or the deferred payment method. If the Court should uphold petitioners' contention that they are entitled to report the sale on the installment or deferred payment method, then a portion of the gain should be reported in 1949, and the net operating loss

carry-back to 1947 should be reduced or eliminated. This will result in an increased deficiency for 1947, claim for which is hereby asserted pursuant to section 6214(a) of the Internal Revenue Code of 1954.

Wherefore, it is prayed:

1. That the petitioners' appeal be denied and that the respondent's determination be approved.

2. In the alternative, if this Court should find and hold that petitioners are entitled to report the gain from the sale on the installment or deferred payment method, that the net operating loss carry-back from 1949 to 1947 be reduced or eliminated with a corresponding increased deficiency for 1947, claim for which has been asserted herein.

/s/ JOHN POTTS BARNES, REM,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel;
E. C. Crouter, Assistant Regional Counsel;
R. E. Maiden, Jr., Special Assistant to the Regional Counsel; Mark Townsend, Attorney;
Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed Nov. 28, 1955.

[Title of Tax Court and Docket No. 52394.]

COMPUTATION FOR ENTRY OF DECISION

The attached computation reflecting a deficiency in income tax and 5% negligence penalty in the re-

spective amounts of \$2,826.87 and \$141.34 for the taxable year 1946, is submitted on behalf of the respondent in compliance with the opinion of the Court determining the issues in this proceeding.

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ JOHN POTTS BARNES, ECC.,
Chief Counsel, Internal Revenue
Service.

Of Counsel:

Melvin L. Sears, Regional Counsel, E. C. Crouter, Assistant Regional Counsel, R. E. Maiden, Jr., Special Assistant to the Regional Counsel, Mark Townsend, Attorney, Internal Revenue Service.

RECOMPUTATION STATEMENT

In re: Albert J. Fihe, 1671 Casale Road, Pacific Palisades, California.

Docket No. 52394

Year	Deficiency	5% Penalty (Negligence)
1946-Income Tax	\$2,826.87	\$141.34

The recomputation of tax liability and penalty shown herein reflects the opinion of The Tax Court of the United States filed June 12, 1956. The decision of The Tax Court will be entered under Tax Court Rule 50.

The 5% addition to tax under section 293(a) of the Internal Revenue Code of 1939, for negligence penalty was sustained by The Tax Court.

ADJUSTMENT TO NET INCOME

Year 1946

Net income per deficiency notice dated 1/14/1954	\$27,181.56
Decrease:	
(a) Partnership income transferred to return of wife	13,663.34
Net income as adjusted.....	\$13,518.22

EXPLANATION OF ADJUSTMENT

(a) It has been stipulated that the petitioner's wife, Elizabeth M. Fihe, was a bona fide partner in the partnership Holly Molding Devices in the year 1946. The wife's share of partnership income, \$13,663.34, included in income in the deficiency notice is, therefore, eliminated.

COMPUTATION OF TAX

Year 1946

Net income	\$13,518.22
Less: Exemptions (4).....	2,000.00
Balance subject to tax	\$11,518.22
Tentative tax	\$ 3,216.92
Less: 5% reduction	160.85
Income tax liability	\$ 3,056.07
Income tax disclosed by return:	
Original, Account No. 2085379, Chicago District	\$ 399.68
Amended return, 4-300828-1948 List....	1,463.08
Total	\$1,862.76
Less: Tentative allowance (IT-CB 23947)	1,633.56
Deficiency of income tax	\$ 2,826.87
5% Negligence penalty	\$ 141.34

Served and Entered Aug. 8, 1956.

[Endorsed]: T.C.U.S. Filed Aug. 6, 1956.

[Title of Tax Court and Docket No. 52396.]

COMPUTATION FOR ENTRY
OF DECISION

The attached computation is submitted, on behalf of the respondent, in compliance with the opinion of the Court determining the issues in this proceeding. Said computation provides that there are deficiencies in income tax and 5% negligence penalty as follows:

Year	Deficiency	5% Penalty (Negligence)
1947	\$ 397.40	\$533.78
1948	\$6,926.70	\$346.34

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ JOHN POTTS BARNES, ECC,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel, E. C. Crouter, Assistant Regional Counsel, R. E. Maiden, Jr., Special Assistant to the Regional Counsel, Mark Townsend, Attorney, Internal Revenue Service.

RECOMPUTATION STATEMENT

In re: Albert J. Fihe and Elizabeth M. Fihe, 1671 Casale Road,
Pacific Palisades, California. Docket No. 52396.

Year	Deficiency	5% Penalty (Negligence)
1947	\$ 397.40	\$533.78
1948	6,926.70	346.34
Totals	<u>\$7,324.10</u>	<u>\$880.12</u>

The opinion of The Tax Court of the United States filed June 12, 1956 sustained the adjustment of tax and penalty liabilities shown in the deficiency notice dated January 14, 1954.

The deficiency and penalty shown above are the amounts shown in the deficiency notice.

Served and Entered Aug. 8, 1956.

[Endorsed]: T.C.U.S. Filed Aug. 6, 1956.

The Tax Court of the United States
Washington

Docket No. 52394

ALBERT J. FIHE, Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 52396

ALBERT J. FIHE and ELIZABETH M. FIHE, Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' PROPOSED FINDINGS

1. Elizabeth M. Fihe was a bona fide member of

the Illinois partnership known as Holly Molding Devices in Chicago during the year 1945 and up to October 1, 1946 when a corporation was formed.

2. Petitioners, Albert J. Fihe and Elizabeth M. Fihe, did, during the years 1936 to 1946 inclusive, jointly invest approximately \$50,000.00 in said partnership.

3. When petitioners sold their stock in the resultant corporation known as Holly Molding Devices, Inc. for \$100,000.00, the payments thereon comprised capital gain, which extended over almost four years, and should be taxed as such rather than all in the one year of 1948. Petitioners erroneously reported this profit as income, rather than capital gains thereby penalizing themselves.

4. Petitioners inadvertently neglected to claim a loss due to an unfortunate investment in a copper mine in the year 1947 and neglected to claim proper credit for dependents in that year.

5. Petitioner Albert J. Fihe did erroneously, but in good faith, twice deduct an item for interest paid in the year 1949, but this was due to the fact that there were two spaces for such interest deductions on the printed return for that year; and he did erroneously deduct the item of Federal Income Taxes paid during the year 1947.

6. Petitioners properly stated their income derived from Holly Molding Devices, Inc. in 1946 and 1947 and any evidence tending to establish addi-

tional income in the respective amounts of \$10,056.57 and \$861.90 is untrue.

7. Petitioners did not at any time under-state their business and other income for the years in question.

8. Petitioners' deductions for business contributions, traveling expenses, losses, etc., etc., during the years in question were all properly substantiated and should be allowed in full.

9. The records of Holly Molding Devices, Inc. submitted in connection with the Wisconsin deposition were all made up after the petitioners had sold all of their stock in the corporation and such revised records did not properly represent alleged disbursements made to the petitioners in the years in question.

10. Petitioner Albert J. Fihe received three weeks salary in the year 1948 from Holly Molding Devices, Inc. totalling \$1200.00, and no additional amounts whatever in the way of salary were paid to him in that year.

11. Petitioners kept accurate records of all their business transactions during 1946 through 1949, properly reported their income for those years, and should not be assessed any penalty for negligence.

12. Petitioner Albert J. Fihe saved the United States Government untold amounts in taxes which never would have been received, if he had not reported the attempted conspiracy between Harry H. Holly, the Internal Revenue Agent and the Com-

pany Auditor, which conspiracy was for the purpose of defrauding the Government.

April 5, 1956.

Respectfully submitted,

/s/ ALBERT J. FIHE,
Counsel for Petitioners.

[Endorsed]: T.C.U.S. Filed April 9, 1956.

[Title of Tax Court and Docket Nos. 52394, 52396.]

PETITIONERS' COMMENTS ON COMPUTATIONS SUBMITTED

1. Petitioners do not disagree with the computations submitted on behalf of Respondent relative to taxes for the year 1946, but they do disagree with the finding of negligence penalty for that year. There was no negligence, an amended return was submitted in good faith by the Petitioners, and the taxes, as determined by this amended return, were paid by the Petitioners at that time. The books of the Petitioners and the partnership were properly kept and audited for the year 1946. The auditing was by a firm of certified public accountants.

2. Petitioners do not disagree with the proposed recomputation of taxes for the year 1947, except as regarding the negligence penalty submitted by Counsel for Respondent as amounting to \$533.78. This is more than the actual tax deficiency, which is \$397.40. As with the year 1946, Petitioners' books

were properly kept and audited by the same firm of certified public accountants.

3. Petitioners disagree with the proposed recomputation of taxes for the year 1948.

According to Respondent's own Brief submitted in this case, Petitioners suffered a business loss of \$16,976.78 in the year 1948. Petitioners' return showed a business loss of \$33,363.88. Regardless of this, the recomputation by Counsel for Respondent indicates that Petitioners are deficient in their taxes for that year in the amount of \$6,926.70. This is obviously wrong. Counsel for Respondent also indicates that a negligence penalty should be assessed against Petitioners for the year 1948. The only negligence on the part of Petitioners for that year was a failure to make any money and, in fact, they suffered a great loss. There should be no taxes or penalties on a business loss. The loss itself is a more than sufficient penalty.

It is noted that the hearing on the computations as submitted is now set for 10:00 a.m. February 13, 1957, in The Tax Court of the United States in Washington, D. C. It is doubtful whether Counsel for Respondents can be in Washington on that date because of other previous commitments.

However, at the hearing on January 9, 1957, Honorable Judge Tietjens suggested that Counsel for Petitioners contact the local offices of the Regional Commissioner in Los Angeles with the view of possibly settling this entire controversy. Accord-

ingly, a copy of these Comments is being mailed to the offices of the Regional Commissioner, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California with a letter requesting a conference to this end.

Burbank, California, January 25, 1957.

Respectfully submitted,

/s/ ALBERT J. FIHE.

[Endorsed]: T.C.U.S. Filed Jan. 28, 1957.

[Title of Tax Court and Docket Nos. 52394, 52396.]

MOTIONS

To the Honorable Judges of The Tax Court of the
United States, Washington, D. C.

In order to place these matters in better condition for purposes of appeal, Petitioners submit the following:

I.

Petitioners contend that there should be no penalty for negligence assessed with regard to their 1946 returns.

As the record shows, Petitioners submitted individual tax returns as partners of Holly Molding Devices of Chicago. Later, an amended partnership return was submitted which was prepared by a firm of certified public accountants and corresponding amended returns were submitted by the Petitioners here.

There is absolutely no reason why a negligence penalty should be assessed against Petitioners under these circumstances.

II.

This Honorable Court, in its memorandum filed June 12, 1956, determined that Petitioners were liable for deficiency tax for the year 1948 in the amount of \$6,926.70, plus a five per cent penalty of \$346.34.

In this same memorandum, the Court determined that profits realized by Petitioners from the sale of their interests in Holly Molding Devices should all be taxed in one year, namely, 1948, even though Petitioners were paid in installments continuing through the next two or three years.

Petitioners did, for the year 1950, report as profit the sum of \$21,000.00 received from Holly Molding Devices as payment on installment notes for that year. According to the Court, this was wrong.

Deducting this apparent profit of \$21,000.00 in order to conform to the Court's ruling, it follows from Petitioners' 1950 return that they experienced a loss of \$22,100.73 in that year.

This loss should accordingly be allowed as a carry-back to apply on the tax assessed for the year 1948.

A copy of this document is today being mailed to the offices of the Regional Commissioner, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California.

Burbank, California, May 9, 1957.

Respectfully submitted.

ALBERT J. FIHE,
Counsel for Petitioners.

[Stamped]: Denied May 14, 1957. /s/ Norman
O. Tietjens, Judge.

Served and Entered May 17, 1957.

[Endorsed]: T.C.U.S. Filed May 13, 1957.

[Title of Tax Court and Docket Nos. 52394, 52396.]

PETITION FOR REHEARING

To the Honorable Judges of the Tax Court of the
United States, Washington, D. C.

The Petitioners herein hereby respectfully request a rehearing. The grounds for this petition are as follows:

The Year 1946

As previously pointed out in Petitioners' motion, filed May 13, 1957, Petitioners submitted individual tax returns as partners of Holly Molding Devices of Chicago. Later, an amended partnership return was submitted which was prepared by a firm of certified public accountants and corresponding amended returns were submitted by the Petitioners.

There is absolutely no reason why a negligence penalty should be assessed against Petitioners under these circumstances.

Also, many proper deductions claimed by Peti-

tioners in their original and amended returns were disallowed by the Court, and Petitioners hereby request that they be given an opportunity to present additional evidence in support of these deductions and to prove that the disallowances of some were erroneous.

The Year 1947

As the record shows, Petitioners were assessed a negligence penalty for the year 1947.

Petitioners' return for that year was prepared from carefully maintained records. Such records were produced in Court at the trial, and Petitioner Albert J. Fihe testified under oath that he personally had supervision of same and had actually made most of the entries himself. Petitioners' return corresponded in all respects with the entries. However, many deductions claimed by Petitioners were disallowed and Petitioners respectfully request an opportunity to resubmit this material for further consideration by the Court and especially with a view to eliminating the negligence penalty.

The Year 1948

At the trial Petitioners produced unpaid notes and other evidence to the effect that they had, over a period of more than five years, invested approximately \$65,000.00 in the partnership business of Holly Molding Devices. Petitioners' long term profit upon selling the business was therefore less than \$35,000.00. The Court ruled otherwise.

Petitioners, when selling the business, received some cash and the remainder in non-negotiable

notes which were at that time of no real value. Payments on these notes continued over a period of almost three years. Petitioners, therefore, did not realize any profit on their original investment until at least the year 1950 or 1951. Petitioners, therefore, should not be taxed on the entire profit in the single year of 1948.

In the year 1950 your Petitioners experienced and reported an actual business loss of over \$20,000.00. This loss should be applied as a carry-back to the year 1948.

Petitioners therefore respectfully request that they be granted a rehearing in the interests of simple justice.

Burbank, California, June 11, 1957.

Respectfully submitted,

/s/ ALBERT J. FIHE,
Counsel for Petitioners.

[Stamped]: Denied June 14, 1957. /s/ Norman O. Tietjens, Judge.

Served and Entered June 18, 1957.

[Endorsed]: T.C.U.S. Filed June 13, 1957.

T. C. Memo 1956-139

Tax Court of the United States

Albert J. Fihe, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Albert J. Fihe and Elizabeth M. Fihe, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket Nos. 52394, 52396. Filed June 12, 1956.

Albert J. Fihe, Esq., for the petitioners.

Mark Townsend, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Tietjens, Judge: The Commissioner determined the following deficiencies in income tax and additions to tax for negligence under Section 293(a):

Year	Deficiency	5% addition to tax for negligence
1946	\$9,515.06	\$475.75
1947	397.40	533.78
1948	6,926.70	346.34

The issues to be decided are:

(1) Did petitioners understate business income for each of the years 1947 to 1949, inclusive, and did they claim excessive itemized deductions in each of said years?

(2) Did petitioners understate income derived and received from Holly Molding Devices, Inc. in 1947 and 1948 by the respective amounts of at least \$10,056.57 and at least \$861.90?

(3) Did petitioners understate the taxable por-

tion of long term capital gain in 1948 derived from the sale of stock in Holly Molding Devices, Inc.?

(4) Did the Commissioner properly determine that the 5 per cent addition to tax for negligence be imposed?

A fifth issue, i.e. whether petitioner Elizabeth M. Fihe was a bona fide partner of Holly Molding Devices in 1946, has been conceded by the Commissioner and the concession can be given effect in a Rule 50 computation.

General Findings of Fact

Petitioners Albert J. Fihe and Elizabeth M. Fihe are husband and wife. They reside in Pacific Palisades, California. Albert filed a separate and an amended return for 1946 with the collector of internal revenue in Chicago, Illinois. Petitioners filed joint returns for the years 1947, 1948 and 1949, the return for 1947 being filed with the collector of internal revenue in Chicago, Illinois, and the returns for the latter two years being filed with the collector of internal revenue in Los Angeles, California.

Albert (sometimes hereafter called petitioner) has been a practicing attorney specializing in patent law for some 34 years. He maintained an office in Chicago for that length of time, closing it in 1948. He has had an office in Los Angeles, California, for 30 years. Petitioners moved from Chicago to California in 1948.

In 1936 petitioners formed a partnership, known as Holly Molding Devices, with Harry Holly. Holly's wife also had an interest in the business.

The partnership engaged in the manufacture and sale of hamburger molds. Holly was the inventor of the device and petitioner furnished his services in procuring the patent. Elizabeth was a bona fide member of the partnership in 1946, having a one-fourth interest therein.

After petitioners moved to California in 1948, Albert engaged in the practice of patent law and the manufacture and sale of fishing equipment.

Issue No. 1
Findings of Fact

The Commissioner's determination of understatement of business income for 1946 was computed as follows:

Expense	Claimed	Allowed	Disallowed
(1) Litigation Expense	\$5,720.30	\$4,720.30	\$1,000.00
(2) Travel Expense	4,763.77	3,226.30	1,537.47
Total disallowed expenses			<u>\$2,537.47</u>
(3) Unreported income—Los Angeles office			749.69
Total			<u>\$3,287.16</u>
(4) Loss, Los Angeles office, claimed on amended return, disallowed			(1,728.42)
Adjustment—increase in business income.....			<u>\$5,015.58</u>

The Commissioner's determination of understatement of business expenses for 1947 was computed as follows:

Expense	Claimed	Allowed	Disallowed
(1) Legal	\$4,269.26	\$1,669.26	\$2,600.00*
(2) Travel	5,881.56	4,433.61	1,447.95
(3) Advertising	1,042.97	487.97	555.00
Total disallowed expenses			<u>\$4,602.95</u>
(4) Gross receipts understated			943.22
Adjustment—increase in business income			<u><u>\$5,546.17</u></u>

* This item represents the payment by petitioner of legal fees for Harry Holly in connection with the defense of a criminal action against Holly.

Business income (loss) per return	(\$ 3,151.10)
Increase per above adjustment	5,546.17

Business income as adjusted \$ 2,395.07

Less:

Net operating loss from 1949 allowed 20,761.06

Business income (loss) as adjusted (18,365.99)

Business loss claimed on return (3,151.10)

Adjustment—decrease in net income \$15,214.89

For 1947 the Commissioner also disallowed certain of the itemized deductions claimed by petitioners as follows:

Deductions	Claimed	Allowed	Disallowed
(1) Contributions	\$ 448.15	\$ 356.15	\$ 92.00
(2) Taxes	7,680.88	1,397.50	6,283.38
(3) Medical—Disallowed because of percentage limitation.			

The Commissioner's determination of understatement of business income for 1948 was computed as follows:

Expense	Claimed	Allowed	Disallowed
(1) Interest	\$3,111.84	\$2,876.44	\$ 235.40
(2) Taxes	2,600.84	2,089.55	511.29
(3) Losses	3,362.44	—0—	3,362.44
(4) Freight	1,630.41	505.96	1,124.45
(5) Legal	3,326.14	2,764.39	561.75
(6) Stationery	2,794.47	2,644.47	150.00
(7) Travel	8,679.14	2,876.17	5,802.97
(8) Commissions	1,426.30	626.30	800.00
(9) Advertising	3,483.94	2,885.80	598.14
(10) Repairs	535.33	460.76	74.57
(11) Postage	732.18	488.85	243.33
(12) Phone & Telegraph	1,323.41	1,251.88	71.53
(13) Depreciation	2,755.11	773.53	1,986.58

Total Disallowed expenses \$15,522.45

(14) Add: Error in addition of deductions on
return 584.20

(15) Unreported Receipts 280.45

Adjustment—increase in business income \$16,387.10

Business income (loss) per return	(\$33,363.88)
Increase per above adjustment	16,387.10

Business income (loss) as adjusted

(\$16,976.78)

For the year 1948 the Commissioner also disallowed certain itemized deductions claimed by petitioners as follows:

Deductions	Claimed	Allowed	Disallowed
(1) Contributions	\$ 664.48	\$ 291.25	\$ 373.23
(2) Casualty loss	2,300.04	—0—	2,300.04
(3) Medical	1,089.34	735.79	Percentage limitation

The Commissioner's determination of understatement of business income for 1949 was computed as follows:

Expense	Claimed	Allowed	Disallowed
(1) Repair	\$2,517.15	\$ 407.13	\$ 2,110.02
(2) Advertising	3,658.25	976.59	2,681.66
(3) Litigation	1,042.22	794.82	247.40
(4) Travel	4,476.41	2,493.24	1,983.17
(5) Interest	3,909.95	3,308.89	601.06
(6) Postage	720.32	471.32	249.00
(7) Depreciation	2,550.40	1,843.23	707.17
(8) Telecast expense			1,661.62
(9) Bandmaster			632.50

Total disallowed expenses

\$10,873.60

(10) Receipts understated

628.78

Total

\$11,502.38

Less: Mathematical error.....

900.00

Net increase in business income

\$10,602.38

For the year 1949 the Commissioner also disallowed certain of the itemized deductions claimed by petitioners as follows:

Deductions	Claimed	Allowed	Disallowed
(1) Contributions	\$ 285.51	\$ 47.51	\$ 238.00
(2) Interest	3,909.95	—0—	3,909.95
(3) Taxes	3,511.44	—0—	3,511.44

In their 1947 return petitioners included federal income and other federal taxes such as "Transportation," "Amusement" and "Pullman" [sic] among their itemized deductions.

In their 1948 return petitioners claimed as business deductions for freight and travel expenses, the cost of moving personal possessions from Chicago to California and the cost of maintaining the family in a hotel until a new home was established.

In their 1948 return petitioners claimed a casualty loss of \$2,300.04 for "Damaged and stolen furniture and stolen wallet." Of this amount \$214 represented cash, which according to petitioner's records, was stolen from a wallet and the remainder represented the cost of purchasing new furniture to replace furniture which petitioner claimed was lost, stolen and damaged in the move to California.

Petitioner deducted automobile expenses which included the cost of travel to and from work. He also deducted the cost of new suits as advertising expenses and testified in that connection, "If I do not look pretty prosperous, I do not get patent business," and "I think it is perfectly good advertising and the only way a lawyer can advertise."

Opinion

On this issue, the deductibility of claimed expense items and the resulting increase in taxable income by virtue of their total or partial disallowance, the determination of the Commissioner "has the support of a presumption of correctness, and the petitioner has the burden of proving it to be wrong," *Welch v. Helvering*, 290 U.S. 111.

Most of the items here involved were disallowed or partially disallowed because they were deemed to be "personal" expenses or were "unsubstantiated" or were "duplication(s)." Petitioners have introduced no evidence which would serve to carry their burden of proving error in the Commissioner's determination. In this respect petitioner's testimony was of the most general nature. No testimony was offered with regard to the amount of specific expense items which would assist the Court in determining whether the allowance made on items partially allowed was correct. Aside from the general testimony of petitioner that such and such items were disallowed (in other words, a mere recital of what the Commissioner did) and the admissions of petitioner that mistakes were made in the returns, which, however, "cut both ways," the record contains no evidence which would help petitioners. What little specific testimony there was with respect to some of the claimed deductions only confirms the propriety of the Commissioner's ruling. We advert here to the deductions claimed for federal income taxes paid, the expense of travel to and from work, the cost of maintaining the family in a hotel pending the establishment of a new home, the cost of new suits, and the \$2,600 attorney fee which petitioner paid to assist Holly in defending himself against criminal charges because, as petitioner testified, "Harry had a family * * * and I really hated to see my partner go to the penitentiary." While this latter testimony evidences a charitable motive, it does not establish the basis for a business deduc-

tion. We hold that the attorney fees are not an ordinary and necessary business expense. Neither are the other items properly deductible.

The record in this case is such that the so-called Cohan rule—*Cohan v. Commissioner*, 39 F. 2d 540 can have no application. There has been no total disallowance of claimed deductions here in the face of a record clearly calling for some allowance. In most instances substantial amounts have been allowed and petitioners have not come forward with evidence which would justify the Court in increasing allowances above those amounts. On items totally disallowed petitioners have offered no substantiating evidence whatever.

Turning to the claimed casualty loss, the record contains little more than that the deduction was claimed on the return for 1948 and petitioner's testimony as follows:

In that connection, when we moved our furniture out here, (to California) it was certainly in a wreck somewhere, because when we got it, most of it was almost irreparably damaged—a beautiful marble top table that we had was just broken into smithereens—some of the fine furniture looked as if it had been dragged through the mud. The upholstery was torn and almost beyond repair. Some valuable lamps were gone completely. My wife had a very valuable ring somewhere in that furniture and it never did get here. May I say that at one time I saw my wife weeping very bitterly when she saw that furniture.

This record falls far short of furnishing a basis for allowing the casualty loss. There was no evidence regarding the loss of cash in a wallet. No fair market value of the damaged furniture has been proved and no basis for the property has been shown. The claimed loss is disallowed for lack of proof. See *Helvering v. Owens*, 305 U.S. 468.

Accordingly this issue must be decided for the Commissioner.

Issue No. 2

Findings of Fact

On or about September 25, 1946, a corporation known as Holly Molding Devices, Inc. (hereafter called the corporation) was formed to carry on the business formerly carried on by the partnership. With the exception of certain improved real estate which was distributed to the former partners, all the assets and liabilities of the partnership were turned over to the corporation in exchange for capital stock which was issued to the former partners. The real estate was rented to the corporation for a time by the former partners. The corporation's name was later changed to Hollymatic Corporation.

Petitioner was named president of the corporation and Elizabeth was named treasurer. During 1946 and 1947 petitioner was in charge of the corporation's books and records. In 1947 petitioner employed Barrow, Wade and Guthrie, a firm of certified public accountants to audit the books.

Both petitioners had authority to draw checks on the corporation provided such checks were countersigned by either Harry Holly or his wife. Prior to

sale by petitioners of their stock in the corporation (as will hereafter appear) corporate checks issued by Holly or his wife were required to be countersigned by one of the petitioners.

The corporate books and records reflect that outstanding liabilities in the respective amounts of \$4,661.49 and \$3,461.29 to petitioner and Elizabeth assumed by the corporation were credited to their personal accounts in 1946.

The corporate books and records reflect that the following amounts were paid to petitioner by check in 1946:

11/1/46 Check for cash.....	\$ 500.00
11/25/46 Check for cash.....	2,000.00
	<hr/>
	\$2,500.00

These items were unexplained.

The books and records of the corporation reflect salary paid or credited to petitioner during 1947 of \$25,920. According to such books, \$14,000 less withholding, was paid to him and \$10,706.20 was credited to his personal account.

The books and records of the corporation reflect the following credits to petitioner's personal account in 1947:

\$ 724.18	Loan to corp.
10,706.20	Accrued salary
140.00	Accrued rent
5,123.03	Patent Installment payments (later reversed)
6,227.21	Patent Installment payments

100.00 Rent

918.12 Minimum on royalties

60.00 Accrued Rent

The books and records of the corporation reflect the following credits to Elizabeth's personal account in 1947:

\$875 to correct advances

140 accrued rent

100 accrued rent

60 accrued rent

The corporation books and records reflect disbursements by check of \$1,000 to petitioner and \$800 to Elizabeth on January 10, 1947 and such disbursements were debited to their personal accounts. The personal records maintained by petitioner reflect receipt of this \$1,800 amount on January 11, 1947.

The corporation books and records reflect a disbursement by check on March 17, 1947 of \$800 debited to the personal account of petitioner. The personal records maintained by petitioner reflect a cash receipt of \$800 from the corporation on March 15, 1947.

The corporation books and records reflect a disbursement by check of \$3,000 to petitioner which was debited to his personal account on April 30, 1947. The personal records maintained by petitioner reflect a cash receipt of \$3,000 from the corporation on April 22, 1947.

The corporation books and records reflect a disbursement by check on April 3, 1947 of \$1,000 which was allocated \$700 to petitioner and \$300 to Eliza-

beth and debited in such amounts to their personal accounts on April 30, 1947. The personal records maintained by petitioner reflect a cash receipt of \$1,000 from the corporation on April 1, 1947.

The corporation books and records reflect two additional disbursements by check of \$700 and \$2,325 in April which were debited to the personal account of petitioner on April 30, 1947. The personal records maintained by petitioner reflect cash receipts from the corporation of \$700 on April 17, 1947 and \$2,325 on April 26, 1947.

The corporation books and records reflect that salary in the amount of \$14,000 was disbursed by checks to petitioner in 1947. The personal records maintained by petitioner reflect cash receipts of salary in the total amount of \$11,523.10. These are net amounts and do not reflect withholding for income and social security taxes.

The corporation books and records reflect a disbursement by check to petitioner on June 20, 1947 of \$3,632.05 which was debited to his personal account on June 30, 1947. The personal records maintained by petitioner reflect a cash receipt of \$3,632.05 from the corporation on June 25, 1947.

The corporation books and records reflect a disbursement by check to petitioner on May 13, 1947 of \$2,600 which was debited to his personal account on May 31, 1947. This check was issued to pay legal fees for Harry Holly pursuant to an agreement with petitioner and the personal records maintained by petitioner do not reflect this amount as a receipt of income.

The corporation books and records reflect a debit of \$5,890 to petitioner's personal account on September 30, 1947. The personal records maintained by petitioner reflect a cash receipt of \$5,890 from the corporation on September 12, 1947.

The corporate books and records and/or the personal records maintained by petitioner reflect that the following amounts were disbursed by checks from the corporation to the petitioners in 1947:

1/10/47	\$ 1,000.00	
1/10/47	800.00	
3/17/47	800.00	
3/21/47	550.00	
4/30/47	3,000.00	
4/30/47)	1,000.00	(Reflected as \$700 debit to
4/30/47)		petitioner and \$300 debit to
		Elizabeth; Reflected as one
		receipt on petitioner's personal
		records)
4/30/47	700.00	
4/30/47	2,325.00	
5/31/47	2,600.00	
6/30/47	2.94	
6/30/47	3,632.05	
6/30/47	408.54	
9/30/47	5,890.00	
12/ 5/47	2,292.36	
Add	11,523.10	(Representing amounts dis-
		bursed by check, roughly net
		of withholding tax, as per cor-
		porate records, and petition-
		er's personal records)
Total	\$36,523.99	

(Note: Above total does not include the \$1,000 option payment of December 13, 1947, hereafter referred to.)

The books and records of the corporation reflect the following credits to petitioner's personal account in 1948:

\$ 42.50	To reverse entry applicable to Old Age Benefit— deducted from employee later.
890.67	To record purchase of furniture and fixtures from A. J. Fihe under agreement dated 1/9/48.
981.90	To close balances of Fihe's accounts, charged to A. J. Fihe's salary.
5,000.00	To record purchase of patent rights, capital stock and land and buildings from A. J. and E. M. Fihe under option agreement dated 12/13/47.

The corporate books and records reflect that petitioner received salary, net of withholding tax, in 1948 in the form of corporate checks as follows:

1/ 2/48	\$327.10	(\$72.90 withheld as taxes)
1/ 9/48	327.10	(\$72.90 withheld as taxes)
1/16/48	327.10	(\$72.90 withheld as taxes)
1/31/48	861.90	

The books and records of the corporation reflect the following debits to petitioner's personal account in 1947 which are not reflected on the personal records maintained by petitioner:

4/30/47	General Journal entry. To transfer advances to officers to proper accounts	\$ 350.00
4/30/47	G. J. entry. Charge back unauthorized sal- aries paid to executives in December	\$1,499.50
4/30/47	G. J. entry. To charge Mr. Fihe for items in equipment account covering Mr. Fihe's filing cabinets for patents and so forth	\$ 563.47
4/30/47	G. J. entry. To charge personal accounts for excess payments on taxes withheld	\$ 86.34
4/30/47	G. J. entry. To charge owners of building for mortgage and interest on same paid by the corporation	\$ 256.25
4/30/47	G. J. entry. Interest on officers life insur- ance loans, paid by the company, charged back to the appropriate officers	\$ 61.58
4/30/47	G. J. entry. To charge portion of traveling expenses to respective officers	\$ 705.96
4/30/47	No explanation	\$1,199.28
4/30/47	To adjust salaries upon which tax has been paid and not deducted	\$ 3.50
4/30/47	Cash disbursement	\$ 2.94

9/17/47	G. J. entry. To charge interest on insurance loans to officers concerned	\$ 34.04
9/30/47	G. J. entry. To correct distribution of check No. 8737 charged to Workmen's Compensation Insurance in error. Insurance agent states that this does not cover a company policy	\$ 250.00
12/ 5/47	Check issued to Mr. Fihe. Explanation of "royalties" crossed out and no explanation given	\$2,292.36
	Total	\$7,305.22

The books and records of the corporation reflect the following debits to Elizabeth's personal account in 1947 which are not reflected on the personal records maintained by petitioner:

3/21/47	Check payable to Mrs. Fihe	\$ 550.00
4/30/47	G. J. entry. To adjust salaries upon which tax has been paid and not deducted.....	\$ 1.75
4/30/47	G. J. entry. To charge back unauthorized salaries paid to executives in December	\$ 449.75
6/30/47	Check payable to Mrs. Fihe	\$ 408.54
	Total	\$1,410.04

With the exception of one entry reflecting the payment of petitioner's income tax by the partnership, petitioners' books and records reflect only receipts which were deposited in petitioners' bank accounts.

Ultimate Findings

The petitioners received or had unfettered command of at least \$10,056.57 and \$861.90 from Holly Molding Devices, Inc. in the years 1947 and 1948, respectively, which they did not report as taxable income in those years.

Opinion

Here against we are faced with the question of whether or not petitioners have carried their burden

of disproving the presumptive correctness of the Commissioner's determinations.

On this phase of the case the Commissioner determined, with respect to the year 1947, that petitioners had received additional income consisting of \$8,890 as dividends and \$1,166.57 as royalties from Holly Molding Devices, Inc. and, with respect to the year 1948, that petitioner had received \$861.90 as additional salary.

As appears from the record, these determinations were based primarily on the books of the corporation and were supported by the testimony of a witness who, at the time of the hearing and for some time prior thereto, had control of such books and records. This witness testified with respect to what the books and records showed with respect to receipts of the petitioners from the corporation in actual cash payments and also credits during the taxable years. For a time prior to sale of their stockholdings in the corporation by petitioners this witness had been charged with the responsibility of entering figures on the payroll account at a time when he was also the corporation's purchasing agent. At the time of the hearing he was comptroller of the corporation, in charge of the corporate books and records. The findings which we have made with respect to this issue are based on the testimony of this witness as to entries contained in the books and records, and while we recognize that books and records are merely evidentiary of the real nature of the transactions they reflect, yet

when we balance the comptroller's testimony against the seemingly contrary evidence, consisting as it does of petitioner's oral denial that he ever "received" the amounts testified to, together with the corroboration of the corporate records by petitioner's own records (which, however, only reflected amounts deposited in his bank accounts), we can only conclude that the evidence fails to overcome the presumption of correctness that attaches to the Commissioner's determination. See A. W. Henn, 20 B.T.A. 1133, pages 1150, 1151, where we said,

It is not enough to justify the exclusion of these items from his gross income derived in the course of complicated financial transactions such as are disclosed by the evidence, for petitioner to say merely that he did not receive the money in his actual possession.

To point up how true this statement is as far as 1947 goes, we point to the \$2,600 item for attorney fees paid by petitioner on behalf of his partner, Holly, in Holly's criminal case. According to the corporate record this item was at the command of petitioner and was expended by him. Yet it does not appear in his personal records as a receipt and was not reported by him as income, though he does (improperly we have held) claim it as a deduction. The failure to include this item is typical of petitioner's explanations on this score. He excused it by saying "I certainly haven't got the money. In fact I spent the money. It is gone." This, of course, is no excuse for failing to include amounts as in-

come which came into petitioner's control at a time when the corporation ostensibly could pay them and when the petitioner was in control of the corporate books and for aught that appears of record could have taken down payment directly.

A facet of petitioner's defense on this issue is his attack on the accuracy of the comptroller's testimony. Petitioner testified that after he and his wife disposed of their stock in the corporation, accountants were called in by the new management to audit the corporate books and that these accountants caused certain entries to be made which are the root of his troubles, inasmuch as so-called corrective entries made by the accountants did not truly reflect the facts. We are of the opinion that this testimony in no way destroys the probative value of the corporate books. The accountants who caused the corrections to be made were the same accountants employed by petitioner himself to audit the records at a time when he himself was in control of the corporation. Their competency is in no way impugned by petitioner's testimony and we have no reason for discounting the accuracy of entries as shown on the books.

Turning to the year 1947 we find that the Commissioner has added \$861.90 as salary to petitioner's income as additional income. For that year petitioner reported he had received salary of \$1,200 from the corporation, yet he attached to his return Form W-2 showing receipt of total wages of \$2,061.90 and withholding tax of \$206.70. It is the

difference between the \$2,061.90 shown by Form W-2 and the reported \$1,200 which the Commissioner has added to petitioner's taxable 1948 income. We find no adequate explanation whatever in the record for petitioner's faulty reporting and have found that the difference of \$861.90 should have been reported as taxable income in accordance with the Commissioner's determination.

While the notice of deficiency states that petitioners understated "dividends and royalties" received from the corporation in 1947 in the respective amounts of \$8,890 and \$1,166.57 and while it is not clear that these respective amounts were actually "royalties and dividends" rather than other forms of taxable income, we think the entire record supports the Commissioner's determination that there was an understatement of at least \$10,056.57 in taxable income for 1947, as well as an understatement of salary in the amount of \$861.90 in 1948. Accordingly, the Commissioner's determinations on this issue are sustained.

Issue No. 3

Findings of Fact

In December 1947 petitioners gave an option to the corporation whereby they agreed to sell to the corporation their capital stock, their interest in patents used by the corporation and their interest in certain improved realty which had been distributed to the partners upon dissolution of the partnership. Petitioners received a payment of \$1,000 on the option on December 13, 1947.

In January of 1948 the corporation exercised the option and paid to petitioners \$24,000 by check. In addition, the corporation gave to petitioners two notes in the total principal amount of \$70,000 secured by a chattel mortgage on the corporate machinery and equipment. Further, a credit was entered to petitioner's personal account on the corporate books in the amount of \$5,000 which settled a debit balance in that amount in his personal account.

The improved realty involved in this transaction was the real estate distributed to the individual partners upon dissolution of the partnership. It was conveyed to the corporation in 1948.

Commencing February 29, 1948 payments were made to petitioners on the notes and mortgage in the amount of \$1,750 per month plus interest. These payments continued until the entire amount was paid. Petitioners received payments on principal totalling \$17,500 in 1948.

The cost of the improved realty distributed to the four partners in September 1946 was \$11,991.32. Petitioner received his interest in the patents transferred to the corporation in exchange for his legal services in obtaining the patents.

The assets and liabilities of the partnership, with the exception of the improved realty, were transferred to the corporation in exchange for capital stock. The capital accounts of the individual partners as of the date of the transfer of the partner-

ship assets and liabilities to the corporation were as follows:

H. H. Holly.....	\$ 8,174.57
Agnes Holly	8,174.57
Albert J. Fihe.....	8,174.57
Elizabeth M. Fihe.....	8,174.57
<hr/>	
Total	\$32,698.28

At the time of the transfer, 200 shares of capital stock were issued by the corporation in the total amount of \$20,000 and paid in surplus was credited in the amount of \$12,698.28. Liabilities of the partnership to petitioners in the total amount of \$8,-122.78 were assumed by the corporation.

Petitioners reported \$41,500 as the amount realized on the sale of their interests to the corporation and a basis for such interests of \$27,624.36.

Petitioners computed on a separate schedule D the amount reported as net capital gain in their 1948 return but did not file the schedule of the return. Petitioners, in computing the net capital gain reported on their 1948 return, deducted losses incurred in the sale of a personal residence and the sale of personal furniture and fixtures.

In his determination the Commissioner disallowed the losses from the sales of the personal residence and of the furniture and fixtures.

The Commissioner also determined that petitioners realized \$100,000 in 1948 from the sale of their interests to the corporation, as follows:

Option payment (made in December 1947).....	\$ 1,000
Cash payment (made in January 1948).....	24,000
Credit to personal account of A. J. Fihe.....	5,000
Face amount of notes and mortgage.....	70,000
	<hr/>
	\$100,000

In computing gain on the sale the Commissioner deducted a basis of \$20,595.37, computed as follows:

Basis of Patents	—0—
Basis of Stock.....	\$16,349.14
Basis of Real Estate: Cost.....	\$11,991.32
Less: Depreciation	
(as adjusted by respondent).....	3,498.86
	<hr/>
	\$ 8,492.46
Petitioners' share thereof (50% of \$8,492.46).....	4,246.23
	<hr/>
	\$20,595.37

Opinion

Petitioners allege error in the Commissioner's determination on this issue as follows:

The Commissioner was in error when disallowing losses on sales of residences and furniture due to removal of business and residence from Illinois to California. The Commissioner erred in computing the long term capital gain and the sale of stock of Holly Molding Devices, Inc. He erred in arbitrarily assuming that the cost of the stock was approximately \$20,000.00, when in fact it was over \$35,000.00. The examiner further arbitrarily assessed the entire receipt for the sale of our interest in Holly Molding Devices, Inc., onto the year 1948. We received approximately \$100,000.00 for the sale of our interests in said corporation, but only \$25,-

000.00 of this was paid in cash, the remainder being secured by a mortgage note on the corporation properties and payable in monthly instalments of \$1,750.00. We reported these sums as received in 1948 and succeeding years, and should not be taxed with the entire amount in a single year when the total was not collected until several years later. Furthermore, the mortgage notes deliberately omitted the words "or order" after our names as payees, thereby making these notes non-transferable. The fact that said notes were non-transferable and non-negotiable eliminates any possibility of a tax payment on the full amount of the sale until such time as the actual amounts of the notes had been collected by us. These non-negotiable promissory notes must be considered as having no fair market value.

The alleged error in disallowing losses on the sale of the residences and furniture, which are shown by the record to have been of a personal nature needs no comment. It is almost axiomatic that such losses are not allowable. That the sales were made because petitioner moved his residence from Chicago to California because he moved his offices there in on way changes the personal character of the transaction. These claimed losses are not proper.

Turning next to the basis for the shares of stock and other property turned over to the corporation in 1948, we note that the Commissioner allowed a basis of \$20,595.37, computed as shown in our findings of fact. Petitioners claimed a basis of \$27,-

624.36. To prove error in the Commissioner's determination, petitioners rely on their self-serving oral testimony to the effect that they advanced from \$36,000 to \$50,000 to the partnership and that these advances should be taken into consideration in computing basis. To corroborate this testimony a series of notes of the partnership to petitioner aggregating some \$12,724.36 dated in 1940 and 1942 were introduced in evidence. One of the notes bore endorsements showing credits of \$6,211.29. This evidence is inadequate to overcome the correctness of the Commissioner's determination of basis which is supported by other evidence of record. Even if we accept at face value petitioners' oral testimony that they made the claimed advances to the partnership it still seems certain that substantial sums were repaid to them which would reduce the cost of their stock. Their testimony as to these transactions is fragmentary at best. They have not come forward with evidence which would establish error in the Commissioner's determination of basis, which is sustained.

Another facet of this issue is petitioners' contention that the Commissioner improperly taxed the full amount of the gain on the sale of the stock and other property to the corporation in 1948 (the year of sale) instead of prorating the gain over the years 1948 and 1949. Petitioners' contention appears to be two-pronged—first, that they are entitled to report on the installment basis and second, that the notes they received in part payment were “non-negotiable” and “must be considered as hav-

ing no fair market value.”

Petitioners are not entitled to report their gain on the installment method. In order to be so entitled the initial payment must not exceed 30 per cent of the total sales price. Here the total price was \$100,000 and in 1948 the record shows that petitioners received at least \$24,000 in cash and monthly payments totalling \$17,500 in 1948, a total of \$41,500. Thus, more than 30 per cent of the purchase price was received in 1948. Accordingly it was not proper for them to use the installment method of reporting. Sec. 44(b), Internal Revenue Code of 1939.

With respect to the claim that the corporate notes received in partial payment were “non-negotiable” and must be taken to have no fair market value, we observe that the notes themselves were not produced in evidence and that there is no evidence in the record establishing that the notes had no fair market value. Having challenged the correctness of the Commissioner’s determination that the notes had value, petitioners assumed the burden “of proving not only that respondent’s (Commissioner’s) determination of value was incorrect, but also what the correct value was, in fact.” *W. H. Batcheller*, 19 B.T.A. 1050, 1055. This burden has not been carried. Petitioners rely on *Dudley T. Humphrey*, 32 B.T.A. 280 and a memorandum opinion of this Court where non-negotiable notes were held to have no fair market value. The cases of *Mainard E. Crosby*, 14 B.T.A. 980 and *Edward J. Hudson*, 11 T.C. 1042 might also have

been cited. All, however, are distinguishable. In Humphrey the opinion specifically states, "The testimony is that the notes had no fair market value." And in Crosby and Hudson the notes were subject "to many complicated agreements and conditions." As stated above, here there is no evidence that the notes had no fair market value, the notes are not in evidence, and so far as the record goes they were not subject to conditions affecting their payment. (As a matter of fact they were paid strictly according to their tenor in a comparatively short time.) Further, the notes were secured by a chattel mortgage which was not shown to have had no fair market value.

With the record in this state we are not constrained to disturb the Commissioner's determination that the notes had a value equal to their face and are to be taken as the equivalent of cash.

Issue No. 4

Findings of Fact

We incorporate by reference the facts heretofore found and in addition find that in 1940 petitioner was admonished by an internal revenue agent to keep more accurate books and records, and that the books and records maintained by petitioner in the taxable years were incomplete and did not properly and accurately reflect the taxable income of petitioners.

Part of the deficiencies for each of the years 1946, 1947 and 1948 is due to negligence on the part of petitioner.

Opinion

We think the facts amply support the Commissioner's addition to tax for negligence. The fact that petitioner was an attorney, coupled with the inadequacy of his books, the character of the deductions and losses claimed (some of which were clearly improper and others, duplications) are sufficient evidence to justify the addition to tax for negligence.

Decisions will be entered under Rule 50.

Served and Entered June 13, 1956.

Tax Court of the United States
Washington

Docket No. 52394

ALBERT J. FIHE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion filed June 12, 1956, petitioner and respondent filed computations for entry of decision which differed. The proceeding was placed on the calendar of September 12, 1956, at Washington, D. C., for hearing pursuant to Rule 50. Petitioner's motions for extension of hearing date filed August 6, 1956,

September 10, 1956, November 13, 1956, February 6, 1957, and April 4, 1957, were granted, finally setting this proceeding on the calendar of May 1, 1957, at Washington, D. C. Petitioner filed motion on April 24, 1957, for further extension of hearing date, which motion was denied. Upon due consideration, it is

Ordered and Decided: That there is a deficiency in income tax and 5 per cent addition to tax for negligence under section 293(a) of the Internal Revenue Code of 1939, in the respective amounts of \$2,826.87 and \$141.34, for the taxable year 1946.

[Seal] /s/ NORMAN O. TIETJENS,
Judge.

Entered April 30, 1957.

Tax Court of the United States
Washington

Docket No. 52396

ALBERT J. FIHE and ELIZABETH M. FIHE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion filed June 12, 1956, petitioners and re-

spondent filed computations for entry of decision which differed. The proceeding was placed on the calendar of September 12, 1956, at Washington, D. C., for hearing pursuant to Rule 50. Petitioners' motions for extension of hearing date filed August 6, 1956, September 10, 1956, November 13, 1956, February 6, 1957, and April 4, 1957, were granted, finally setting this proceeding on the calendar of May 1, 1957, at Washington, D. C. Petitioners filed motion on April 24, 1957 for further extension of hearing date, which motion was denied. Upon due consideration, it is

Ordered and Decided: That there are deficiencies in income tax and 5 per cent additions to tax for negligence under section 293(a) of the Internal Revenue Code of 1939, for the taxable year 1947, in the respective amounts of \$397.40 and \$533.78, and for the taxable year 1948, in the respective amounts of \$6,926.70 and \$346.34.

[Seal] /s/ NORMAN O. TIETJENS,
Judge.

Entered April 30, 1957.

Served and Entered May 1, 1957.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket Nos. 52,394, 52,396

[Title of Cause.]

NOTICE OF FILING OF PETITION
FOR REVIEW

Chief Counsel, Internal Revenue Service, Washing-
ton 25, D. C.

Sir: Notice is hereby given of the filing of a peti-
tion for review in the above entitled matters.

/s/ ALBERT J. FIHE,
Attorney for Petitioners-
Appellants.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. July 31, 1957.

[Title of Court of Appeals and Causes.]

PETITION FOR REVIEW

To the Honorable the Judges of the United States
Court of Appeals for the Ninth Circuit:

Petitioners above named hereby request review
by this Honorable Court of the decisions of the
Tax Court of the United States entered in the
above matters on April 30, 1957.

The reasons for this petition are as follows:

1. The Honorable Judge of the Tax Court erred

in holding that Petitioners understated their business income for the years 1947 to 1949, inclusive, and erred in not allowing itemized and proper deductions in each of said years.

2. The Honorable Judge erred in holding that Petitioners understated income derived from the corporation known as Holly Molding Devices, Inc., of Chicago, Illinois, for the years 1947 and 1948. Petitioners assert that the corporate records were deliberately changed and falsified after Petitioners sold their interests and stock in the company.

3. The Tax Court erred in taking into consideration the fact that the then president of Holly Molding Devices, Inc., namely Harry H. Holly, was an ex-convict, having served a term in the federal penitentiary for attempted income tax evasion and also for actual bribing of an internal revenue agent. The statements and records of such a person should not be given precedence or preference over the word of a reputable attorney, sworn to uphold the Constitution, and especially as he actually reported Holly's wrong doings to the Federal Bureau of Investigation and the Internal Revenue Department.

4. The Judge of the Tax Court erred in holding that the Petitioners did not invest at least \$35,000.00 to \$50,000.00 in the corporation's predecessor partnership known as Holly Molding Devices during the ten years of 1936 to 1945, inclusive, and in ruling that the Petitioners realized a long term capital gain of about \$80,000.00 when selling

their stock in the corporation in 1948. Petitioners' profit was not over \$50,000.00, and was distributed over several years.

5. The Judge erred in assessing a negligence penalty against the Petitioners for each of the years 1946, 1947 and 1948, regardless of the fact that Petitioners' 1946 return was prepared by a firm of certified public accountants and regardless of the fact that Petitioners at the trial submitted books of record showing careful and individual entries for all their business transactions for the years 1947, 1948 and 1949, which corresponded with their returns for those years.

6. The Tax Court erred in ruling that the non-negotiable notes which Petitioners received when selling their stock in the corporation represented actual cash and taxed Petitioners accordingly. Payments on these notes extended over a period of more than three years, and taxes should accordingly have been so distributed. The Court erred in taxing the Petitioners on the entire sum in the year 1948, although payments were never assured and could not have been collected by Petitioners under any circumstances in the one year 1948.

7. The Court erred in determining a tax deficiency against the Petitioners of approximately \$7,000.00 for the year 1948, when, in fact, Petitioners experienced and reported a business loss of over \$20,000.00 in the year 1950, which should be applied as a carry-back to the year 1948. Petitioners' profits for 1948 were not substantial in any event.

8. The Judge erred in not recognizing the proven fact that Petitioners saved the United States Government untold sums of money in reporting the wrong-doings and fraudulent actions of Harry H. Holly, his company auditor and the Internal Revenue agent conspiring with them. The honesty and integrity of the Petitioners have been proven to be above reproach and any reasonable doubt should be resolved in Petitioners' favor.

Petitioners reside in Pacific Palisades, California, filed their returns for 1946 and 1947 with the Collector of Internal Revenue in Chicago, Illinois, and filed their returns for 1948 and 1949 with the Collector of Internal Revenue in Los Angeles, California. This establishes venue in the Ninth Circuit.

July 23, 1957.

Respectfully submitted,

/s/ ALBERT J. FIHE,
Attorney for Petitioners-
Appellants.

/s/ ELIZABETH M. FIHE.

[Endorsed]: T.C.U.S. Filed July 29, 1957.

[Title of Tax Court and Docket Nos. 52394, 52396.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 23, inclusive, constitute and are all of the original papers, as called for by the "Designation of Contents of Record on Review", including Petitioners' exhibits 2 thru 8, (9 Marked for Identification and not left with the record), 10 thru 12, admitted in evidence, and Respondent's exhibits A thru M, admitted in evidence, but excepting the document in item 2 which is not of record, in the cases before the Tax Court of the United States docketed at the above numbers and in which the Petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court cases, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of September, 1957.

[Seal] HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

The Tax Court of the United States

Docket Nos. 52394, 52396

ALBERT J. FIHE, ALBERT J. FIHE and
ELIZABETH M. FIHE, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DEPOSITION OF FRANK H. WISCONS

The deposition of Frank H. Wiscons, taken on behalf of the Respondent, in the above-entitled case before Roscoe C. Giles, Jr., a notary public of Cook County, Illinois, and the duly authorized agent of R. C. Herchenroeder, on the 10th day of October, A.D. 1955, at Room 16139, 17 North Dearborn Street, Chicago, Illinois, pursuant to the Order to Take Depositions hereto annexed.

Present: Mr. Paul Levin appeared for respondent; Mr. Albert J. Fihe appeared for petitioners. Mr. Wolgel, Internal Revenue Agent. [1]*

Mr. Levin: This is a deposition of Frank H. Wiscons of Hollymatic Corporation, which we are taking under an order of The Tax Court of the United States, dated August 24, 1955, a copy of which order I am presenting now to the court reporter.

* Page numbers appearing at top of page of Original Deposition.

(Deposition of Frank H. Wiscons.)

(Document tendered.)

Mr. Levin: Present at the deposition are myself, Paul Levin, Counsel for Respondent, Mr. Albert J. Fihe, Petitioner and Counsel per se, and Mr. Wolgel, Internal Revenue Agent, and the Witness, Frank H. Wiscons of Hollymatic Corporation.

FRANK H. WISCONS

called as a witness by the Respondent, pursuant to order under Rule 45 of the Rules of Practice Before the Tax Court of the United States, having been first duly sworn, testified as follows:

Examination

Q. (By Mr. Levin): What is your name?

A. Frank H. Wiscons.

Q. Where do you reside, Mr. Wiscons?

A. 10717 South Keller Avenue, Oaklawn, Illinois.

Q. By whom are you employed?

A. Hollymatic Corporation.

Q. Where is that located?

A. 433 West 83rd Street.

Q. Chicago, Illinois? [3]

A. Chicago, Illinois.

Q. What are your duties with the Hollymatic Corporation? A. I am the comptroller.

Q. How long have you been employed as comptroller?

A. I became comptroller of Hollymatic the beginning of 1948—the early months of 1948.

(Deposition of Frank H. Wiscons.)

Q. What did you do for the Hollymatic Corporation before that?

A. I was the purchasing agent.

Q. Who had control and custody of the books and records of Hollymatic Corporation during the years 1946 and 1947?

A. My only recollection is Mr. Fihe used to handle the books.

Q. That is Albert J. Fihe who is the petitioner herein?

A. That is right, sir.

Q. Are these books and records kept in your control and custody now?

A. Yes, sir.

Q. Are these books and records which you brought here, pursuant to subpoena, the books and regular records of Hollymatic Corporation?

A. Yes, sir.

Q. Have you examined the books and records of Hollymatic Corporation for the years 1946 and 1947?

A. Have I examined them?

Q. Yes. [4]

A. I looked them over prior to bringing them down here.

Q. Does it appear that they are the books and records that were made in the regular course of business?

A. Yes.

Q. Was it the regular course of business to maintain such books and records of Hollymatic Corporation?

A. Yes, sir.

Q. Would you please tell what books and records were maintained by Hollymatic Corporation?

A. Well, in the years 1946, 1947, they had a

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cash book, cash receipts, and cash disbursements. I do not recall having any general journal or general ledger at that time; and I think there was a purchase journal and a sales journal.

Q. Mr. Wiscons, when was the Hollymatic Corporation organized?

A. Hollymatic Corporation was organized on October 1, 1946.

Q. Prior to that time what was the company known as? A. Holly Molding Devices, Inc.

Q. Was it known as such during the years 1946 and 1947?

Strike that.

Now, then, the books and records of Hollymatic Corporation contained an account showing the capital stock of the corporation as of October 1, 1946?

A. Yes, sir. [5]

Q. In what book would that be found?

A. That would be in the general ledger.

Q. Would you please tell the Court what the capital stock was as of October 1, 1946?

A. \$20,000.

Q. Do the books and records also contain an account showing the paid in surplus as of October 1, 1946? A. Yes, sir.

Q. Would you please look at the books and records and tell the Court what the paid in surplus was as of that date?

A. The paid in surplus was \$12,698.28.

Q. Directing your attention to the date October 1, 1946, can you look at the books and records and

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see whether there is a liability account due to Albert J. Fihe and Elizabeth M. Fihe?

Mr. Fihe: Before he answers, may I have the question repeated, please, Mr. Giles?

(Question read.)

Mr. Fihe: Thank you.

The Witness: Yes, there was.

Q. (By Mr. Levin): Was there any liability reflected as of October 1, 1946?

A. Yes, there was.

Q. What was the amount of that liability, please, as shown by the books and records? [6]

A. Shown for Albert J. Fihe was \$4,661.49; for Mrs. Elizabeth M. Fihe, \$3,461.29.

Q. Would you please examine the books and records and advise the Court when these liabilities were finally liquidated?

A. The total of the liabilities were liquidated January 31, 1948.

Mr. Fihe: May I have that answer read?

(Answer read.)

Q. (By Mr. Levin): In what account, Mr. Wiscons, are those liabilities reflected?

A. That is the personal account of Mr. Albert J. Fihe and Mrs. Elizabeth M. Fihe.

Q. And they have separate accounts; is that correct? A. That is right.

Q. Do those books and records of Hollymatic Corporation show the amount of salary paid to and credited to Mr. Albert J. Fihe during the year 1947? A. They do.

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Q. Where would that be reflected, Mr. Wiscons?

A. Well, we have a payroll record book here, and—let's see—we have executive salaries. Also, we have it under the category "Salaries Executives".

Q. Is that posted to a ledger account of the individual officers? [7]

A. It is posted to the subsidiary payroll account of each individual.

Q. Do you have the subsidiary payroll account which reflects the salaries to Mr. Albert J. Fihe?

A. I have that, sir.

What year was that?

Q. For the year 1947. A. 1947.

Q. Will you please tell the Court what the books and records of Hollymatic Corporation show was paid or credited as salary to Albert J. Fihe for the year 1947?

A. For the year 1947, we paid or credited to Mr. Albert J. Fihe \$25,920.

Q. Would you please read the entries of that subsidiary payroll book?

A. The total for the second quarter, which began May 9, 1947: A total of \$3600 was paid to Mr. Fihe for that quarter. The total of the third quarter paid to Mr. Fihe was \$5,200. The total of the fourth quarter was \$5,200 plus \$11,920 which was credited to his personal account.

Q. Would you please look at the books of the Hollymatic Corporation, specifically the general journal, and read the entry of April 30, 1947, by

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which the \$11,920 was credited to the salary account—was charged to the salary account?

A. April 30, 1947—— [8]

Mr. Fihe: Before he answers the question, may I have it read back, please?

(The question was read as follows:

“Q. Would you please look at the books of Hollymatic Corporation, specifically the general journal, and read the entry of April 30, 1947, by which the \$11,920 was charged to the salary account?”)

Mr. Fihe: Let us get it exactly the way the question was asked, please, in the actual words; and if there was a correction or an indication of a correction, please have the record show the same.

Now, will you again read it back, please.

(The question was read as follows:

“Q. Would you please look at the books of Hollymatic Corporation, specifically the general journal, and read the entry of April 30, 1947, by which the \$11,920 was credited to the salary account—was charged to the salary account?”)

Mr. Fihe: That is all you have?

The Reporter: It is, Mr. Fihe.

The Witness: The entry you are speaking of is \$23,840; was charged to executive salary.

Q. (By Mr. Levin): Would you please read the debits or credits?

A. There was a debit of \$23,840; a credit of \$85 was against the O. A. B. tax—employees; a credit of \$2,444.60 [9] was credited to employees’

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income taxes withheld; a credit of \$10,706.20 was credited to the account of Albert J. Fihe; and a credit of \$10,604.20 was credited to the account of Harry H. Holly.

Mr. Fihe: Would you please read the answer?
(Answer read.)

Q. (By Mr. Levin): Would you please also read the legend that goes with the entry?

A. All right. The explanation is: To set up executive salaries accrued but not paid for seven months ended April 30, 1947.

Mr. Fihe: I had better have the complete answer read, please.

(The answer was read as follows:

“A. There was a debit of \$23,840; a credit of \$85 was against the O. A. B. tax employees; a credit of \$2,444.60 was credited to employees’ income taxes withheld; a credit of \$10,706.20 was credited to the account of Albert J. Fihe; and a credit of \$10,604.20 was credited to the account of Harry H. Holly.

“The explanation is: To set up executive salaries accrued but not paid for seven months ended April 30, 1947.”)

Q. (By Mr. Levin): Mr. Wiscons, do the books reflect how much of an [10] amount, shown as officer’s salary to Albert J. Fihe, was credited to personal drawings? A. Yes, it does.

Q. Would you please examine the books and records and advise the Court how much of it was credited to personal drawings?

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A. \$10,706.20 of this subsidiary payroll ledger was credited to personal account of Mr. Albert J. Fihe.

Q. What do the records show for the balance of the amounts shown as salaries on the books?

A. I do not follow you there, Mr. Levin.

Q. Would the balance be paid by check?

A. That is right, the balance would be paid by checks.

Q. Now, Mr. Wiscons, are the corporation's expenses ordinarily recorded on the books and records of the Hollymatic Corporation?

A. They are entered into the cash disbursements book, under the name of the persons that drew the check, and the charge is made to the account, such as advertising or travel expense or something similar to that. That is made in the cash disbursements book.

Q. Would any of the corporate expenses be charged against drawings?

A. Would you please state that once more?

(Question read.)

A. I am afraid I cannot answer that. I don't know just [11] how those things were set up at that time. There are some entries here which credit Mr. Fihe on journal entries, and there are also some journal entries that charge the personal account.

Q. Do you have those——

Mr. Fihe: I object to the last part of the answer as purely volunteered. The witness has already testified that he did not know.

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I move that said portion of the answer be stricken.

May it be noted on the record that counsel for respondent has just pointed to a portion of the open page of the book which the witness is holding, and that the witness did make an inaudible answer.

Q. (By Mr. Levin): Mr. Wiscons, do you have the cash disbursements record of Hollymatic Corporation for the year 1946 with you?

A. From October 1, 1946, yes.

Q. Directing your attention to November 30, 1946——

A. Yes?

Q. (Continuing) ——would you please tell the Court what the records of Hollymatic Corporation show as being debited to the personal account of Mr. Albert J. Fihe?

A. We have shown as a debit to the account of Albert J. Fihe, \$2,500 from the cash disbursements book.

Q. Is there an explanation as to that amount?

A. Let's see. No, sir, all it is is a check made out November 1, for \$500 to Mr. Albert J. Fihe, and a check on November 25, 1946, made payable to Mr. Albert J. Fihe for \$2,000.

Q. Do you have the cash disbursements record for the Hollymatic Corporation for the year 1947?

A. Yes, I have.

Q. Directing your attention to January 31, 1947, would you please tell the Court what the books and records of Hollymatic Corporation show as debited

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to the personal account of Mr. Albert J. Fihe?

A. There is an entry in our general ledger as of January 31, debiting Mr. Albert J. Fihe for \$1,000.

Q. Is there any explanation as to that amount?

A. No, sir, there is just a check issued on January 10 in the amount of \$1,000 and charged to the account of Albert J. Fihe.

Q. Directing your attention to March 31, 1947, would you please tell the Court what, if any, debits were made to the personal account of Mr. Albert J. Fihe?

A. March 31: There was a debit of \$800 to the account of Mr. Albert J. Fihe.

Q. Is there any explanation for that amount?

A. No, there isn't. There was a check issued on March 17 in the amount of \$800 and charged to Mr. Albert J. Fihe's account. [13]

Q. Directing your attention to April 30, 1947, would you please tell the Court what debits were made, if any, to the personal account of Mr. Albert J. Fihe?

A. What was the date, please?

(Record read.)

A. April 30, 1947: We have two entries in our general ledger to the account of Mr. Albert J. Fihe; one in the amount of \$3,725 and the other in the amount of \$3,000 even.

Q. Are there any explanations for those amounts?

A. The one for \$3,000 has an explanation. It was written to Mr. A. J. Fihe, and the explanation is "loan from corporation."

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The other amount of \$3,725 was issued in the form of three checks, two of them in the amount of \$700 each, and one in the amount of \$2,325 even.

Q. Do those contain any explanation?

A. Those last three, no, sir.

Q. Do you have the general journal of Hollymatic Corporation for the year 1947 with you, Mr. Wiscons?

A. Yes, sir, I have.

Q. Directing your attention to April 30, 1947, what credits are shown on the books and records of Hollymatic Corporation on that day—that is, a credit to the personal account of Albert J. Fihe?

A. There is one credit, dated April 30, in the amount of \$724.18. [14]

There is another one credited in the amount of \$10,706.20.

There is another one credited on April 30, in the amount of \$140; and there is another credited on April 30 in the amount of \$5,123.03.

Q. Directing your attention to the one of \$724.18 is there an explanation as to that shown on the books and records of Hollymatic Corporation?

A. The one for \$724.18 Entry No. 7 on April 30, charging “notes payable policy holders bureau, for \$1,079.76, crediting the account of Albert J. Fihe in the amount of \$724.18, crediting Harry H. Holly in the amount of \$355.58.

The explanation in the journal is: To credit A. J. Fihe and Harry H. Holly for proceeds of insurance loans advanced to the corporation.

Q. Directing your attention to the credit of \$10,-

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706.20, would you please tell the Court what explanation the books and records show as to that credit?

A. That is Entry No. 12 in our journal as of April 30. The debit is to executive salaries for \$23,840 even.

Q. Is this the same entry which you have previously read into the record, Mr. Wiscons?

A. Yes, I re-read this entry. I do not think we have to re-read it, then. It is in the record.

Q. Directing your attention to the credit to the account [15] of Albert J. Fihe of \$140, would you please tell the Court what explanation the books and records of Hollymatic Corporation show as to that amount?

A. On April 30 we have Entry No. 28 set up: debiting the account of rent for \$560 even; crediting the accounts of Albert J. Fihe, \$140 even; Harry H. Holly, \$140 even; Elizabeth M. Fihe, \$140 even; Agnes Holly, \$140 even.

The explanation is: to set up rent on building at 6733 South Chicago Avenue for seven months ended April 30.

Q. Directing your attention to the credit to the account of Albert J. Fihe for the amount of \$5,123.03, would you please tell the Court what explanation, if any, there was as to that amount?

A. That is Entry No. 48. The debit is for liability from minimum payment under the patent purchase contract in the amount of \$5,955.40. We have another debit to the account of patent expense. That amount is \$4,290.66.

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The credit on that entry is Albert J. Fihe for \$5,123.03; and Harry H. Holly is credited for \$5,123.03. Explanation: to set up patent instalment payments due for seven months ended April 30, 1947, based on sales.

Q. Directing your attention to the personal account of Albert J. Fihe in the books and records of Hollymatic Corporation, specifically on the date April 30, 1947, were there any credits made to that account—I mean—correct that to read debits made to that account. [16]

Mr. Fihe: Do you have the question as given, Mr. Reporter?

The Reporter: Yes, sir.

The Witness: There is debited on April 30, \$3,725 to the personal account of Mr. Fihe. On April 30, again, \$3,000; on April 30, again, \$1,199.28, \$3.50, \$1,499.50; \$563.47; \$86.34; \$350 even, \$256.25, \$61.58; \$705.96, and the last one on April 30 was \$5,123.03.

Q. (By Mr. Levin): Directing your attention to the debit \$350 made on April 30, will you please tell the Court what explanation there is, if any, in the records of Hollymatic Corporation as to that entry?

A. On April 30 Entry No. 21, we debited the account of Harry H. Holly for \$350; we debited the account of Albert J. Fihe for \$350. We debited the account of Agnes Holly \$175 and we credited the account of Elizabeth M. Fihe \$875 even.

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The explanation is: to transfer advances to officers to proper accounts.

Q. Directing your attention to the amount of \$1,499.50, would you please tell the Court what explanation there is as to that entry?

A. That is Entry No. 13, dated April 30, debiting the account of Albert J. Fihe \$1,499.50, debiting Harry H. Holly, [17] \$1,499.50; debiting Elizabeth M. Fihe \$449.75; debiting Agnes Holly, \$449.75. The credit is to salaries and wages of \$3,898.50.

The explanation is: to charge back unauthorized salaries paid to executives in December.

Q. Directing your attention to——

Mr. Fihe: Hold it just a moment please.

Thank you.

Q. (By Mr. Levin): Directing your attention to the debit in the account of Albert J. Fihe in the amount of \$5,000—strike that—in the amount of \$563.47, would you please tell the Court what explanation there is in the books and records of Hollymatic Corporation as to that amount?

A. That is Entry No. 14, dated April 30, debiting the account of Albert J. Fihe, \$563.47; crediting equipment, \$563.47. Explanation: charge Mr. Fihe for items in equipment account covering Mr. Fihe's filing cabinets for patents and so forth.

Q. Directing your attention to the amount of \$86.34, would you please tell the Court what explanation there was to that amount?

A. That is Entry No. 15, dated April 30. The

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debit is to Albert J. Fihe for \$86.34. The debit is to Harry H. Holly for \$86.33; the credit to employees' income taxes withheld, \$172.66.

The explanation is: to charge personal accounts for excess payments on taxes withheld. [18]

Q. Directing your attention to a debit to the personal account of Albert J. Fihe in the amount of \$350 would you please tell the Court what explanation there is, if any, to that amount?

A. I read that.

Mr. Levin: Strike that.

Q. (By Mr. Levin): Directing your attention to the amount of \$256.25 debited to the account of Mr. Albert J. Fihe, would you please tell the Court what explanation there is, if any, as to that amount.

A. That is Entry No. 37, dated April 30, a debit to Albert J. Fihe in the amount of \$256.25, to Harry H. Holly in the amount of \$256.25, Elizabeth M. Fihe, in the amount of \$256.25; Agnes Holly, \$256.25; and the credit is first mortgage payable, \$1,000 even. There is an additional credit to interest of \$25.

The explanation is: to charge owners of building for mortgage and interest on same paid by the corporation.

Q. Directing your attention to the debit \$61.58 on April 30, 1947, would you please tell the Court what explanation there is as to that?

A. That is Entry No. 38; Albert J. Fihe was debited for \$61.58; Harry H. Holly was debited

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for \$30.23. Interest was credited for \$91.81. The explanation is: interest on [19] officers' life insurance loans, paid by the company, charged back to the appropriate officers.

Q. Directing your attention to the amount of \$705.96, shown as a debit to the personal account of Albert J. Fihe, would you please tell the Court what explanation there is, if any, as to that amount?

A. Entry No. 39 is debited to Albert J. Fihe in the amount of \$705.96; a debit to Harry H. Holly in the amount of \$1,794.97; credit—travel expense, \$2,500.93. Explanation: to charge portion of traveling expenses to respective officers as above.

Q. Directing your attention to the debit of \$5,123.03, shown as a debit to the personal account of Albert J. Fihe, would you please tell the Court what explanation there is after that amount?

A. That is Entry No. 49. The debits are for liability for minimum patents payments under instalment contract for purchase of patents. The amount is \$170,000. The next debit is to patents in the amount of \$5,955.40. The following debit is to the account of Albert J. Fihe, \$5,123.03. The last debit is to the account of Harry H. Holly of \$5,123.03.

The credits are as follows: patents, \$170,000 even. Patent expense, \$5,955.40. Liabilities for minimum payment under instalment contract for purchase of patent, \$5,955.40; patent expense, \$4,290.66. [20]

The explanation is: to cancel journal entries Nos.

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31, 47, and 48, relative to patent payments contract for purchase not signed.

Mr. Levin: It is now 11:25. We will recess for lunch and resume at 12:30.

(Whereupon, a recess was taken until 12:30 o'clock, p.m.) [21]

Afternoon Session, 12:30 P.M.

(Whereupon the deposition was resumed, pursuant to the taking of the recess, at 12:30 o'clock p.m.)

FRANK H. WISCONS

called as a witness by and on behalf of the Respondent, and, having been previously duly sworn, was examined and testified further as follows:

Examination—(Continued)

Q. (By Mr. Levin): You are the same Mr. Wiscons who was previously sworn in and testified this morning, are you not? A. Yes, sir.

Q. Mr. Wiscons, directing your attention to the books and records of the Hollymatic Corporation, showing the personal account of Albert J. Fihe with respect to the date May 31, 1947, what debits, if any, are recorded on that date?

A. We have a debit from the cash disbursements book to the account of Mr. Fihe in the amount of \$2,600.

Q. Do you have that cash disbursement book here? A. Yes, I have.

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Q. Will you please look into the cash disbursements book and state what explanation, if any, appears there?

A. The entry is made as of May 13, issued check to Albert Fihe in the amount of \$2,600. The explanation is: loan from the corporation. [22]

Q. Directing your attention, Mr. Wiscons, to June 30, 1947, what debits were made to the personal account of Albert J. Fihe on that date, if any?

A. There is an entry here from the cash disbursements book debiting Mr. Albert J. Fihe in the amount of \$3,634.99.

Q. Would you please look at the cash disbursements book and tell the Court what explanation there is as to that amount?

A. There are two entries. One is made to cash and charged to the account of A. J. Fihe for \$2.94. The next entry was made on June 20 as a check issued to Mr. Albert J. Fihe in the amount of \$3,632.05; and there is no explanation as to what that is. That combines to total \$3,634.99.

Q. Directing your attention to September 30, 1947, what debits, if any, were made to the personal account of Albert J. Fihe on the books and records of Hollymatic Corporation?

A. September 30, 1947, we have a debit in the amount of \$34.04; another debit in the amount of \$5,890 even; another debit in the amount of \$250 even; and that is all the debits as of September 30.

Q. Will you please examine—strike that.

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On what books of the Hollymatic Corporation are entered the original debits and credits with respect to those items?

A. With respect to these items, those are all journal entries made in the general journal of Hollymatic Corporation. [23]

Q. Will you please tell the Court what explanation, if any, and the entries which were made to reflect those debits which were made in the general journal book?

A. The amount of \$34.04—this is Journal Entry No. 4, dated September 7—is a debit to the account of A. J. Fihe; and there is a debit to the account of Harry H. Holly in the amount of \$16.71. The credit for that is credited to interest expense in the amount of \$50.75.

Q. Would you please read the debit as shown on the book, Mr. Wiscons?

A. \$34.04 to the charge of Mr. A. J. Fihe and a debit of \$16.71 to Mr. Harry H. Holly.

Q. Would you please read the explanation as to that?

A. The explanation is—for this is: to charge interest on insurance loans to officers concerned.

The next charge is \$5,890 which is Entry No. 10 of September 30.

Q. Of 1947?

A. 1947.

The debits for that entry were \$37.35 debited to back charges; \$50 was debited to the accounts receivable; \$1.25 was debited to salesman's salaries;

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\$75 was debited to advertising expense; \$5,890 was debited to Mr. A. J. Fihe.

The credits on that transaction were credit cash, \$6,037.11. Discounts allowed five cents; payroll cash [24] account, \$1.86; freight, \$14.12; the returns and allowances, one penny. Explanation is: to correct errors in cash detail record.

The next debit on September 30 in the amount of \$250 was debited to Mr. A. J. Fihe. The credit was insurance expense, \$250. This Entry No. 11 is dated September 30, 1947, by the way.

The explanation is: to correct distribution of Check No. 8737 charged to Workmen's Compensation Insurance in error on November 14, 1946. Insurance agent states that this does not cover a company policy.

Q. Directing your attention, Mr. Wiscons, to September 30, 1947, what credits, if any, appear on the personal account of Albert J. Fihe?

A. There are two credits that appear on the personal account and both are dated September 30, one in the amount of \$6,227.21; the other in the amount of \$100 even.

Q. Please read the explanation which appears on the books and records of Hollymatic Corporation with respect to those debits—credits.

A. Entry No. 13, dated September 30, 1947, a debit to the patent expense for \$4,290.66; a debit to liability for minimum payment under patent contract, \$8,163.75.

The credit is to Albert J. Fihe in the amount

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of \$6,227.21, and the other credit is to Harry H. Holly in the amount of \$6,227.21. [25]

The explanation is: Patent instalment due under contract for year ended 9/30/47.

The next journal entry dated September 30, 1947, Entry No. 27 is charged debit rent, \$400; credit A. J. Fihe, \$100; credit Elizabeth M. Fihe, \$100; credit Harry Holly, \$100; credit Agnes Holly, \$100.

The explanation is: to charge rent on building at \$80 per month for five months ended 9/30/47.

Q. Directing your attention to December, 1947, what debits, if any, appear on the personal account of Albert J. Fihe on the books and records of Hollymatic Corporation?

A. One debit appears in the amount of \$2,292.36.

Q. Would you please read the explanation which appears in the books and records of Hollymatic Corporation with respect to that item?

A. There is one entry here: a check issued to Mr. Fihe on December 13, in the amount of \$1,000. The explanation was: corporation deposit on option.

There is also another entry here on December 5, 1947, where a check was issued to Mr. Albert J. Fihe in the amount of \$2,292.36, which is the amount that is on this.

Q. What explanation, if any, is shown for that?

A. It was written down here "royalties", and then it was scratched out and there is no explanation as far as I can see. [26]

Q. Directing your attention to December 20, 1947, what credits, if any, were shown to the per-

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sonal account of Mr. Albert J. Fihe on the books and records of Hollymatic Corporation?

A. December 20, we have one credit shown on the account of Mr. Albert J. Fihe in the amount of \$918.12.

Q. Would you please tell the Court what explanation is shown on the books and records of Hollymatic Corporation with respect to that debit and the source from which you are reading?

A. I am reading from the general journal of Hollymatic Corporation, and it is Entry No. 5. The debit is to the liability for minimum payment on patent purchase in the amount of \$1,836.25. The credit was to the account of Harry H. Holly in the amount of \$918.13, and a credit to the account of A. J. Fihe in the amount of \$918.12.

The explanation is: to record minimum on royalties.

Excuse me. There is one more entry on December 31, of 1947, which is a credit of \$60 to the account of Albert J. Fihe.

Q. Would you please read the explanation pertaining to that credit?

A. That entry is made December 31, 1947.

Q. In what book is the entry made?

A. This is made in the general journal of Hollymatic Corporation, debiting rent \$240, crediting A. J. Fihe, \$60; crediting H. H. Holly, \$60; crediting Elizabeth Fihe, \$60; crediting Agnes Holly, \$60.

The explanation is: to accrued rents under lease agreement. [27]

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Q. Directing your attention to January 31, 1948, what credits, if any, appear on the books and records of Hollymatic Corporation with respect to the personal account of Albert J. Fihe.

A. There are four credits on January 31: one in the amount of \$42.50; another in the amount of \$890.67; another in the amount of \$981.90; and the last in the amount of \$5,000 even.

Q. Would you please read the explanation for those credits and the source from which you are getting the explanation?

A. I am getting this information from the general journal of Hollymatic Corporation. The entry is made on January 31, to accrued OAB tax—employee; a debit of \$85 accrued OAB tax—employee, of \$85.

The credits are: H. H. Holly in the amount of \$42.50; A. J. Fihe in the amount of \$42.50; OAB taxes in the amount of \$85 even.

The explanation is: to reverse audit in Journal Entry No. 12 dated April 30, 1947, applicable to OAB. This was deducted from the employees later.

The next credit of \$890.67 is debited furniture and fixtures, \$890.67; credit A. J. Fihe, \$890.67.

The explanation is: to record purchase of certain [28] furniture under purchase agreement, dated January 19, 1948.

The next credit entry in the amount of \$981.90—that is dated January 31, 1948, debit officers' salaries \$861.90; debit Elizabeth M. Fihe, \$120 even; credit Mr. A. J. Fihe \$981.90.

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The explanation is: to close balances of Fihe's accounts, charged to A. J. Fihe's salary.

The next entry in the personal account is in the amount of \$5,000. This is found on page 8 of the journal, general journal, dated January 31, 1948; debit patents \$45,000 even; debit treasury stock \$50,000 even; debit land \$5,000 even; credit option \$25,000 even; credit mortgage payable \$70,000 even; credit Mr. A. J. Fihe \$5,000 even.

Explanation: to record purchase of patent rights, capital stock, and land and buildings from Mr. A. J. Fihe and Elizabeth M. Fihe under option agreement dated December 13, 1947.

Q. After that last credit, Mr. Wiscons, what do the books and records show as the balance of the personal account of Albert J. Fihe?

A. They show a zero balance at that time.

Q. Mr. Wiscons, do the books and records of Hollymatic Corporation also contain the personal account for Elizabeth M. Fihe?

A. Yes, it does. [29]

Q. Would you please turn to that account?

I believe you testified previously that as of October 1, 1946, the credit balance in that account was \$3,461.29; is that correct?

A. That is correct, sir.

Q. Directing your attention to October 31, 1946, what debits, if any, appear on the books and records of Hollymatic Corporation to the personal account of Elizabeth M. Fihe?

A. October 31, 1946, there is one debit that ap-

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pears and that is from the cash disbursements book in the amount of \$300 even.

Q. Would you please read the explanation that appears on the books and records of Hollymatic Corporation with respect to that debit?

A. Well, there were checks issued to Mrs. Elizabeth M. Fihe, dated October 18, in the amount of \$25. It seems as though all the checks that were issued on those days were charged to Mrs. Fihe—they were charged to Mrs. Fihe, but it seems as though they were issued to somebody else.

Q. Does your cash disbursements book show a column with respect to the items which were drawn by Elizabeth M. Fihe?

A. That is right, they do.

Q. Were those items posted into the ledger sheet for the personal account of Mrs. Elizabeth M. Fihe? A. They were, sir. [30]

Q. Would you please read from your cash disbursements book the persons to whom the checks were made out which were posted to the account of Mrs. Fihe?

A. A check in the amount of \$50 made payable to Mr. Harry Holly was posted to the account of Mrs. Fihe.

A check in the amount of \$50, made payable to Albert J. Fihe, was posted to Mrs. Fihe.

A check in the amount of \$25, payable to Mrs. Fihe was posted to Mrs. Fihe.

A check in the amount of \$25 to Agnes Holly was posted to Mrs. Fihe.

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A check in the amount of \$50 payable to Albert J. Fihe was posted to Mrs. Fihe.

A check in the amount of \$50 made payable to Harry H. Holly was posted to Mrs. Fihe.

A check in the amount of \$25, payable to Elizabeth M. Fihe was posted to Mrs. Fihe.

A check in the amount of \$25 for Agnes Holly was posted to Mrs. Fihe's account.

Q. What was the total of all of those amounts you just read? A. \$300.

Q. Is there any explanation with respect to those amounts? A. None at all, sir.

Q. Directing your attention to November 30, 1946, what [31] credits, if any, were shown on the personal account of Mrs. Elizabeth M. Fihe?

A. On November 30 there are two debits to the account of Elizabeth M. Fihe: one in the amount of \$750 even; and the other in the amount of \$700 even.

Q. Would you please tell the Court what explanation the books and records show with respect to those items?

A. A check in the amount of \$50——

Q. What book are you reading from?

A. Cash disbursements book, date November, 1946.

A check in the amount of \$50 paid to Mr. A. J. Fihe, charged to Mrs. Elizabeth Fihe. A check in the amount of \$50 paid to Harry H. Holly posted to Mrs. Fihe. A check in the amount of \$25 paid to Mrs. Fihe, posted to Mrs. Fihe. A check in the

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amount of \$25 paid to Agnes Holly, posted to Mrs. Fihe. A check in the amount of \$50 paid to Albert J. Fihe, posted to Mrs. Fihe. A check in the amount of \$50 paid to Harry Holly, posted to Mrs. Fihe. A check in the amount of \$25 paid to Mrs. Elizabeth Fihe, posted to Mrs. Fihe. A check in the amount of \$25 paid to Mrs. Holly, Agnes Holly, posted to Mrs. Fihe. A check in the amount of \$50, paid to Mr. Albert J. Fihe, posted to Mrs. Fihe. A check in the amount of \$50 paid to Harry Holly, posted to Mrs. Fihe. A check in the amount of \$25, paid to Elizabeth M. Fihe, posted to Mrs. Fihe. A check in the amount of \$25, paid to Agnes Holly, posted to Mrs. Fihe. A check in [32] the amount of \$50 paid to Albert J. Fihe, posted to Mrs. Fihe. A check in the amount of \$50, paid to Harry Holly, posted to Mrs. Fihe. A check in the amount of \$25, paid to Agnes Holly, posted to Mrs. Fihe. A check in the amount of \$25, paid to Elizabeth Fihe, posted to Mrs. Fihe; \$50, paid to Albert J. Fihe, posted to Mrs. Fihe; \$50 to Harry H. Holly, posted to Mrs. Fihe; \$25 to Elizabeth M. Fihe, posted to Mrs. Fihe; \$25, paid to Agnes Holly, posted to Mrs. Fihe.

Now, I will have to find that additional \$700: On November 18, a check was issued to Elizabeth M. Fihe in the amount of \$700 with no explanation.

Q. Directing your attention to January 31, 1947, what debits, if any, are shown on the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

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A. On January 31, 1947, we have one debit in the amount of \$800, which was posted from the cash disbursements book.

Q. Will you *please to* the Court any explanation that the Hollymatic Corporation has in its books and records with respect to that item?

A. The amount of \$800 derives from a check issued to Elizabeth M. Fihe on January 10, 1947, in the amount of \$800. This is from our cash disbursements book.

Q. Is there any explanation with respect to that, outside of the entry? [33]

A. No, sir.

Q. Directing your attention to March 31, 1947, what debits, if any, are reflected in the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

A. There is one entry dated March 31, 1947, which comes from the cash disbursements book in the amount of \$550 even.

Q. Will you please read to the Court any explanation appearing on the books and records of Hollymatic Corporation with respect to that item?

A. Out of the cash disbursements book, dated March 21, 1947, we issued a check payable to Elizabeth M. Fihe in the amount of \$550 even.

Q. Directing your attention to April 30, 1947, what debits, if any, are shown on the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

A. For the month of April 30, 1947, there are

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three debit entries in our general journal—excuse me—general ledger, charged to Mrs. Fihe; one of those figures derives from the cash disbursements book and two derive from the general journal book.

Q. What amounts are shown on the books as debits?

A. There is an amount of \$300 from the cash disbursements book. There is an amount of \$1.75 in the general journal, and an amount of \$449.75 in the general journal as of April 30.

There is one other entry here in the general [34] journal in the amount of \$256.25.

Q. Is that in addition to the ones you have mentioned recently? A. That is right, sir.

Q. That is a debit entry?

A. That is a debit entry, yes, sir.

Q. Would you please give the Court any explanation that appears on the books and records of Hollymatic Corporation with respect to these items?

A. The \$300 figure derives from a check issued to Mr. Albert J. Fihe in the amount of \$1000 on April 3rd, \$700 of this amount being charged to A. J. Fihe and \$300 being charged to the account of Elizabeth M. Fihe.

The first journal entry in the amount of \$1.75 is Entry No. 10, dated April 30, 1947, debiting the account of Albert J. Fihe, \$3.50; Elizabeth M. Fihe, \$1.75; Agnes Holly, \$1.75; Harry H. Holly, \$3.50, an unadjusted account because of an unlocated dif-

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ference in the amount of \$4.60. The credit entry is: accrued OAB Tax—Employee, \$15.10.

Explanation: to adjust salaries upon which tax has been paid and not deducted—journal entry in the amount of \$449.75—it is Entry No. 13.

Q. For what date is that entry?

A. That is dated April 30, 1947.

Q. Let me just ask this one question: Had you previously [35] read the explanation with respect to that item of \$449.75 shown as a debit on April 30, 1947, to the personal account of Elizabeth M. Fihe?

A. I have previously read that.

The next entry in the amount of \$256.25, which is a journal entry, has also been reported in the record.

Q. Would you identify that as to date and item number?

A. That is Item No. 37 where we had charged the owners of the building for mortgage and interest on sum paid by the corporation.

Q. The explanation for that item had been previously read into the record?

A. That has been, sir.

Q. Directing your attention to April 30, 1947, what credits, if any, appear on the records of Holymatic Corporation to the personal account of Elizabeth M. Fihe?

A. There are two credit entries entered in our journal, dated April 30, 1947, one in the amount of

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\$875 even and the other in the amount of \$140 even.

Q. Would you advise the Court please, on what date those items appear in your general journal?

A. They appear as of April 30, 1947.

Q. What item number was that entry?

A. That is Item No. 21, which has previously been reported.

Q. That item has previously been read into the record? [36]

A. That is right, sir.

Q. That was for the credit in the amount of \$875?

A. That is right—transfer the advance to officers to the proper accounts.

The next item, in the amount of \$140, was dated April 30, 1947, Entry No. 28.

Q. Has that explanation shown on the books and records of Hollymatic Corporation previously been read into the record?

A. It has been, sir.

Q. Directing your attention to June 30, 1947, what debits, if any, are shown on the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

A. There is one entry debited to Elizabeth M. Fihe from our journal record, dated June 30, 1947.

Q. What is the amount of that debit?

A. The amount of that debit is—I am sorry, I gave the wrong amount.

Q. Would you give it—

A. \$408.54.

Q. Would you please tell the Court what ex-

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planation of that amount is shown on the books and records of Hollymatic Corporation?

A. That comes from our cash disbursements book, a check made payable to Elizabeth M. Fihe on June 20 in the amount of [37] \$408.54, check No. 9658.

Q. Directing your attention to September 30, 1947, what credit, if any, appears on the books and records to the personal account of Elizabeth M. Fihe?

A. There is one credit entry as of that date in the amount of \$100 even.

Q. Please tell the Court what explanation appears on the books and records of Hollymatic Corporation with respect to that item?

A. That is Item No. 21, dated September 30, 1947. That is where we had set up the charge to rent on the old building at \$80 per month for five months ended September 30, 1947.

Q. Has that explanation previously been read into the record? A. Yes, it has.

Q. Directing your attention to December 30, 1947, what credit, if any, appears on the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

A. There is one credit entry made in the amount of \$60 even.

Q. Please tell the Court what explanation there is for that item on the books and records of Hollymatic Corporation?

A. That was an item on December 31, 1947,

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where we had accrued to rent under the lease agreement; and that has been [38] previously set into the record already.

Q. Directing your attention to January 31, 1948, what debits, if any, appear on the books and records of Hollymatic Corporation with respect to the personal account of Elizabeth M. Fihe?

A. There is one debit entry in the amount of \$120 even, dated January 31.

Q. Will you please tell the Court what explanation appears on the books and records of Hollymatic Corporation with respect to that item?

A. That is an item dated January 31, 1948, debiting officers' salaries \$861.90; debiting Elizabeth M. Fihe, \$120 even; and crediting Mr. A. J. Fihe for \$981.90.

Q. Will you please tell the Court what explanation, if any, appears on the books and records of Hollymatic Corporation?

A. That explanation was read before: to close the balance of Mr. A. J. Fihe's account, charged to A. J. Fihe, salary.

Q. Directing your attention to January 31, 1948, after the debit you just explained of \$120 to the personal account of Elizabeth M. Fihe, what balance, if any, was in that account?

A. There was zero balance at that time.

Q. In what book would be recorded the officers' salaries paid or credited to Mr. Albert J. Fihe during the year 1948?

A. Will you repeat that again?

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(Question read.) [39]

A. The salary paid would be recorded in the subsidiary payroll book.

Q. Do you have that subsidiary payroll ledger with you? A. Yes, I have.

Q. Would you please advise the Court what amount of salary shown for Mr. Albert J. Fihe during the year 1948?

The Witness: Was that 1948?

The Reporter: Yes.

The Witness: The total amount paid to Mr. Albert J. Fihe on the payroll records for 1948 was \$2,061.90.

Q. (By Mr. Levin): Would you please read the period for which each check or each salary was paid and the total amount of the payment?

A. On January 2, 1948, a check in the amount of \$400 was issued to Mr. Albert J. Fihe; January 9, 1948, a check in the amount of \$400 was issued to Mr. Fihe; on January 16, 1948, a check in the amount of \$400 was issued to Mr. Fihe; on January 31, 1948, a check in the amount of \$861.90 was issued to Mr. Fihe.

Q. Were you reading the amount of the check, Mr. Wiscons, or the total amount of salary?

A. That was the total amount of salary.

Q. What deductions would have been taken from that to show what the check was?

A. The deductions for OAB on January 2 were \$4.00. [40] Withholding tax deducted was \$68.90

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a total of \$72.90 in deductions; a net amount of \$327.10.

On January 9, there was a deduction of \$4.00 for OAB tax, \$68.90 for withholding taxes; a total of \$72.90 deducted, getting a net amount of \$327.10.

On January 16, a deduction of \$4.00 for OAB tax, \$68.90 deducted on income taxes; a total deduction of \$72.90; net amount paid, \$327.10. The check in the amount of \$861.90 had no deductions.

Q. Calling your attention, Mr. Wiscons, to your general journal entry of January, 1948, with respect to officers' salaries, would you please look at that entry?

The Witness: What was that date?

(Question read.)

Q. (By Mr. Levin): Would you also look at the subsidiary payroll ledger for the salary of A. J. Fihe for the year 1948?

Now, in your general journal, the entry of December 31, 1947, with respect to officers' salaries, what debit appears there for officers' salaries?

A. \$861.90.

Q. Is there any relationship between that \$861.90 and the one appearing on the subsidiary payroll ledger showing Mr. Fihe's salary for 1948?

Mr. Fihe: If he knows. [41]

Mr. Levin: If he knows, yes.

The Witness: I would not know.

Mr. Levin: Will it be all right with you, Mr. Fihe, if I take about a five-minute break?

Mr. Fihe: No, perfectly all right. I mean, yes.

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(Short recess.)

Q. (By Mr. Levin): Mr. Wiscons, directing your attention to January 22, 1948, specifically with reference to the disbursements record, would you please advise the Court whether checks were drawn on that date for the payment of the option?

A. What was the date?

(Record read.)

A. On that date, there were two checks made payable, one to Harry H. Holly in the amount of \$20,000 even, and a second check to the Southeast National Bank in the amount of \$4,000.

Mr. Fihe: That entry is objected to as absolutely immaterial, incompetent, and irrelevant, and having nothing to do with this case. I move that the answer be stricken.

Q. Directing your attention to the disbursements book with reference to January 20, 1948, do the records reflect any payments on an option on that date?

A. No, sir, I see no record on that.

Q. Do the records of Hollymatic Corporation reflect a [42] mortgage payable on or about December 13, 1947?

Mr. Fihe: Which is objected to as leading.

Q. (By Mr. Levin): Directing your attention to the general journal of Hollymatic Corporation, with specific reference to January 31, 1948, was there an entry made on the record to purchase of patent rights and capital stock on land and buildings from A. J. Fihe under option agreement?

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Mr. Fihe: Same objection—leading.

Motion will be made to strike the answer.

Q. (By Mr. Levin): Do the books and records of Hollymatic Corporation in the year 1947 reflect any mortgage payable accounts?

Mr. Fihe: Let me have the question, please, Mr. Giles.

(Question read.)

Mr. Fihe: Same objection—leading; also irrelevant, incompetent, and immaterial.

Mr. Levin: Would you answer that, Mr. Wiscons?

Mr. Fihe: He can answer that “yes” or “no.”

The Witness: What was that year—1947?

(Record read.)

Q. (By Mr. Levin): I wish to direct your attention——

Mr. Fihe: Pardon me.

There will be an objection to a further question; he [43] has not answered the one preceding.

What was the exact question, Mr. Giles?

(Question read.)

Mr. Fihe: Thank you.

The Witness: Yes, there is some question of a mortgage in the year 1947.

Mr. Fihe: Motion will be made to strike out the answer on the grounds of the preceding objection, and also objection is made to any subsequent testimony regarding the same.

Q. (By Mr. Levin): Directing your attention to the journal entry which you have read into the

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record, dated January 31, 1948, I ask you what reference is made to the mortgage in any entry made on that date?

Mr. Fihe: The objection is repeated.

Mr. Levin: You may answer that.

Mr. Fihe: You are getting all this down?

The Reporter: Yes, sir.

The Witness: January 31, we made an entry in our journal debiting the account of patents, \$45,000, debiting treasury stocks, \$50,000; debiting land \$5,000; crediting option, \$25,000; crediting mortgage payable, \$70,000; crediting A. J. Fihe \$5,000.

The explanation is: to record the purchase of patent rights, capital stock, land and buildings from A. J. Fihe [44] and Elizabeth M. Fihe under option agreement, dated December 13, 1947.

Mr. Fihe: The preceding motion is repeated—namely, to strike out the answer as unresponsive, irrelevant, immaterial, incompetent, and based on a leading question.

Q. (By Mr. Levin): To what book is the mortgage payable item posted?

A. That is posted to our general ledger.

Q. Referring to the general ledger, would you please read the debits and credits contained therein with respect to the mortgage payable account? Will you please read the debits and credits entered therein?

Mr. Fihe: The objection is repeated.

The Witness: Do you wish me to answer that?

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Mr. Levin: Yes, please.

The Witness: We have one credit entry under the account of mortgage payable in the amount of \$70,000, dated January 31, 1948.

Then, we have a debit entry of \$1,750, dated February 29.

Q. (By Mr. Levin): What year was that?

A. 1948.

We have another one dated March 31, 1948, of \$1,750.

We have another dated April 30, 1948, in the amount [45] of \$1,750.

We have another one dated May 31, in the amount of \$1,750.

We have another one dated June 30, 1948, in the amount of \$1,750.

We have another one dated July 31, 1948, of \$1,750.

We have another one dated August 31, 1948, in the amount of \$1,750.

We have another one dated September 30, 1948, of \$1,750.

Q. (By Mr. Levin): Directing your attention to the debit of \$1,750.00 appearing on February 29, 1948, from what source did you get that item?

Mr. Fihe: The objection is made continuing.

The Witness: We received a note from the City National Bank & Trust Company, paying them \$1,750 on the mortgage payable, and \$408.03, interest expense that was paid on——

Q. (By Mr. Levin): Pardon me. I believe you

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did not answer the question. From what source did you get that—from what book of original entry did you get that?

A. I am sorry. From the cash disbursements book.

Q. Would you please read the explanation shown on the cash disbursements journal with respect to that item? [46]

A. On February 18 we made a check payable to the City National Bank & Trust Company, our check No. 10684 in the amount of \$2,158.33.

The explanation is: \$1,750 to apply against the mortgage payable; \$408.33 to be applied to interest expense.

Q. Directing your attention to a \$1,750 debit on March 31, 1948, will you please advise the Court where that is shown on your books and records?

A. That is shown on our cash disbursements book.

Q. Will you please read the explanation?

A. On March 26, 1948, we issued a check in favor of City National Bank and Trust Company, our check No. 107—excuse me, it is 10809; the amount of the check was \$2,034.37; explanation: \$1,750 charged to mortgage payable account, \$284.37 charged to interest expense account.

Q. Directing your attention to April 30, 1948, specifically to the debit of \$1,750, would you please explain to the Court the explanation on the books and records of Hollymatic Corporation as to that item?

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A. That was posted from our cash disbursements book.

Q. Please read the explanation.

A. On April 26, we issued a check in the favor of City National Bank and Trust Company, our check No. 10939, the total being \$2,027.08. We charged mortgage payable for \$1,750; we charged interest expense account \$277.08. [47]

Q. Directing your attention to May 31, 1948, with respect to a debit shown on the mortgage payable account on the books and records of Hollymatic Corporation in the amount of \$1,750.00, would you please explain to the Court the source and explanation of that item?

A. The item of \$1,750 derives from an entry in our cash disbursements book as of May 31.

Q. Please read the entry into the record.

A. On May 26, 1948, we issued a check in favor of City National Bank, our check No. 11083, the amount of the check being \$2,019.78. Of that amount, \$1,750 was posted against the notes payable as a debit, and \$269.78 was posted as a charge to the interest expense account.

Q. Directing your attention to June 30, 1948, respecting a debit which appears on the mortgage payable ledger account of Hollymatic Corporation, in the amount of \$1,750 would you please explain what the books and records show with respect to that item?

A. That derives from a check issued in our cash

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disbursements book in the amount of \$1,750 as of June 30.

Q. Would you please read that into the record as it appears on the cash disbursements book?

A. On June 29, 1948, we issued a check in favor of City National Bank, our check No. 11198, in the amount of \$2,012.50. Of that amount \$1,750 was debited to the mortgage payable and [48] \$262.50 was debited to interest expense.

Q. Directing your attention to July 31, 1948, respecting a debit on the mortgage payable account of Hollymatic Corporation, will you please tell the Court the source and details respecting that item?

A. This is posted from the cash disbursements book as of July 31. The amount is \$1,750. On July 26, 1948, we issued a check in favor of City National Bank, our check No. 11314, the total amount being \$2,005.20. Of this amount, \$1,750 was debited to mortgage payable and \$255.20 was debited to interest expense account.

Q. Directing your attention to August 31, 1948, respecting a debit in the mortgage payable ledger of Hollymatic Corporation, in the amount of \$1,750, will you please explain to the Court the details as they appear on the books and records of Hollymatic Corporation, with respect to that item?

A. That item is posted from the cash disbursements book as of August 31, the amount being \$1,750. On August 30, we issued a check in favor of City National Bank, our check No. 11455, the amount being \$1,997.91. Of this amount, \$1,750

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was posted as a debit to mortgage payable, and \$247.91 was debited to the interest expense account.

Q. Directing your attention to September 30, 1948, regarding a debit shown on the mortgage payable ledger of Hollymatic Corporation, in the amount of \$1,750, will you please [49] explain to the Court the details concerning that item?

A. That is posted from our cash disbursements book, dated September 30, 1948, the amount being \$1,750. There was a check issued in favor City National Bank, on September 24, 1948, our check No. 11578, the total being \$1,990.61. Of this amount \$1,750 was debited to mortgage payable, and \$240.61 was debited to interest expense account.

Q. Are there any other debits appearing on that ledger of accounts?

A. At that time, no, sir.

Q. Directing your attention to the general journal of January 31, 1948, specifically to the entry which has been previously read into the record, referring to the option of \$25,000, where in the books and records of Hollymatic Corporation was that posted?

Mr. Fihe: What was that amount, Mr. Giles?

(Record read.)

The Witness: It was posted in the general journal account as a credit.

Q. (By Mr. Levin): Do the books of ledger account for that item? A. Yes, they do.

Q. Will you please tell the Court what debits

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and what credits appear with respect to that account on the books and records of Hollymatic Corporation? [50]

A. There are two debits in that account: one dated December 19, 1947, which derives from our cash disbursements book in the amount of \$1,000; the other debit is dated January 31, 1948, and that is from our cash disbursements book in the amount of \$24,000 even. There is one credit, dated January 31, 1948, and that is derived from our journal book in the amount of \$25,000 even.

Q. Reference is made to the entry dated January 31, 1948, with respect to a credit appearing on the option ledger account of \$25,000.

Will you please tell the Court the details surrounding that entry?

A. That entry derives from an entry on January 31, 1948. It is on page No. 8, the debit to patents of \$45,000 even; debit to treasury stock of \$50,000 even; debit land, \$5,000 even; credit option, \$25,000 even; credit mortgage payable, \$70,000 even; credit A. J. Fihe, \$5,000 even.

The explanation is: to record purchase of patent rights, capital stock, land and buildings from Mr. A. J. Fihe and Elizabeth Fihe under option agreement dated December 13, 1947.

Mr. Fihe: The answer is objected to on the basis of the previous objection, and also because it is merely a repetition of previous testimony.

The motion is made to strike. [51]

Q. (By Mr. Levin): Your attention is directed

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to an entry appearing to the option ledger account of Hollymatic Corporation, dated December 19, 1947, showing a debit of \$1,000.

Will you please explain to the Court what the books and record of Hollymatic Corporation show with respect to that item?

A. That is an item that has been posted from our cash disbursements book on December 19, in the amount of \$1,000 even. On December 13, a check was made payable to Mr. A. J. Fihe, check No. 10451, in the amount of \$1,000. The explanation is: corporation deposit on option.

Q. Your attention is directed to an entry appearing on the option ledger sheet of Hollymatic Corporation, an entry dated January 31, 1948, reflecting a debit of \$24,000.

Will you please explain to the Court what the books and records of Hollymatic show concerning the details surrounding that item?

A. This item is picked up from the cash disbursements book of \$24,000 as of January 31, 1948. On January 22, 1948, a check was drawn in favor of Harry H. Holly, Check No. 10592, in the amount of \$20,000. The explanation is marked: option.

A check on January 22, 1948, was drawn in favor of Southeast National Bank, Check No. 10593, in the amount of \$4,000 even. The explanation is marked option. [52]

Mr. Fihe: The answer is objected to as a repetition of an answer that has previously been given

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and which was properly objected to at the time.
Motion is made to strike.

Mr. Levin: The respondent is finished with his direct examination with respect to this deposition.

Examination

Q. (By Mr. Fihe): Mr. Wiscons, you realize you are under oath here? A. Yes, I do.

Q. You realize also that is a Federal matter?

A. I do that, sir.

Q. Do you know the penalty for perjury?

A. Not fully.

Q. You testified that Hollymatic Corporation was organized in October, about the first of the month, in 1946? A. That is right, sir.

Q. What was the predecessor of Hollmatic Corporation? A. Holly Molding Devices.

Q. Is that the full name?

A. Inc., incorporated.

Q. When was Holly Molding Devices incorporated?

Mr. Levin: To which I have an objection—if he knows.

Mr. Fihe: He seemed to know pretty well when he was testifying on direct.

Can you answer that question?

The Witness: When was Holly Molding Devices—— [53]

Q. (By Mr. Fihe): ——incorporated?

A. I cannot answer. I do not know the answer.

Q. How about Hollymatic Corporation—of what

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state is that a corporation? A. Illinois.

Q. How about Holly Molding Devices—of what state was that a corporation, if you know?

A. Illinois.

Q. You do know that it was in Illinois?

A. I assume that. I do not know.

Q. You were employed by one of these corporations on or about October 1, 1946; is that correct.

A. It was prior to October 1, 1946.

Q. Tell me, do you know what is or was the relationship between Holly Molding Devices, Inc., and Hollymatic Corporation?

A. All I understand is that the name was changed—that is all—from Holly Molding Devices, Inc., to Hollymatic Corporation.

Q. And you say that was about the first of October, 1946 to the best of your knowledge?

A. To the best of my knowledge, Holly Molding Devices or Hollymatic Corporation was incorporated, or originally incorporated in October, 1946, yes.

The name was changed since that time to Hollymatic Corporation—only the name. [54]

Q. In your capacity as comptroller for the present organization, is it your custom or a part of your duties to give Dun & Bradstreet information regarding the financial status of the company?

A. It is, sir.

Q. I show you a document which I am marking for identification as Petitioner's Exhibit 1, and I will ask you to look at that, please.

(Deposition of Frank H. Wiscons.)

(Petitioner's Exhibit Number 1 was marked for identification.)

(Document tendered.)

Q. You have examined the document, Exhibit 1?

A. Yes, sir.

Q. Does your name appear in that document, Mr. Wiscons? A. Yes, it does.

Q. Are you willing to change your testimony with regard to the date of organization of Hollymatic Corporation, in view of that document, Petitioner's Exhibit 1?

A. If you mean on September 25, 1946——

Q. No, I mean a much later date than that with regard to any date around October 1, 1946.

A. The corporation, known as Holly Molding Devices, was incorporated on September 25, or we used the fiscal year 1946. The name "Holly Molding Devices" just changed to Hollymatic [55] Corporation, but there were no rules or anything else that changed excepting the name. That was changed when we moved over to the new building.

Mr. Fihe: Mr. Reporter, will you please read about the first dozen answers of this witness on direct examination, please.

(The record was read as follows:

"Q. By whom are you employed?

A. Hollymatic Corporation.

Q. Where is that located?

A. 433 West 83rd Street.

Q. Chicago, Illinois? A. Chicago, Illinois.

Q. What are your duties with the Hollymatic

(Deposition of Frank H. Wiscons.)

Corporation? A. I am the comptroller.

Q. How long have you been employed as comptroller?

A. I became comptroller of Hollymatic the beginning of 1948—the early months of 1948.

Q. What did you do for the Hollymatic Corporation before that?

A. I was the purchasing agent.

Q. Who had control and custody of the books and records of Hollymatic Corporation during the years 1946 to 1947?

A. My only recollection is Mr. Fihe used to handle the books. [56]

Q. That is Albert J. Fihe who is the petitioner herein? A. That is right, sir.

Q. Are these books and records kept in your control and custody now? A. Yes, sir.

Q. Are these books and records which you brought here, pursuant to subpoena, the books and regular records of Hollymatic Corporation?

A. Yes, sir.

Q. Have you examined the books and records of Hollymatic Corporation for the years 1946 and 1947? A. Have I examined them?

Q. Yes.

A. I looked them over prior to bringing them down here.

Q. Does it appear that they are the books and records that were made in the regular course of business? A. Yes.

Q. Was it the regular course of business to maintain such books and records of Hollymatic

(Deposition of Frank H. Wiscons.)

Corporation? A. Yes, sir.

Q. Would you please tell what books and records were maintained by Hollymatic Corporation?

A. Well, in the years 1946, 1947, they had a cash book, cash receipts, and cash disbursements. I do not recall having any general journal or general ledger at that time; and I think [57] there was a purchase journal and a sales journal.

Q. Mr. Wiscons, when was the Hollymatic Corporation organized?

A. Hollymatic Corporation was organized on October 1, 1946.

Q. Prior to that time what was the company known as?

A. Holly Molding Devices, Inc.

Q. Was it known as such during the years 1946 and 1947?

Strike that.")

Mr. Fihe: That is enough, thank you, Mr. Reporter.

Do we have a question on the record at this time?

(Record read.)

Q. (By Mr. Fihe): Now, Mr. Wiscons, are you willing to change your direct testimony, having heard it read to you? A. No, sir.

Q. Let me remind you that you state, and you have just heard read to you, that Hollymatic Corporation was organized about the first of October, 1946, and that its predecessor was Holly Molding Devices, Inc., both being Illinois corporations.

(Deposition of Frank H. Wiscons.)

That is what you said on your direct. Are you still adhering to that testimony?

Mr. Levin: I object to that question. I think you are mis-stating the direct, personally.

Mr. Fihe: Let the record be read back again, then. [58] Everybody heard what he said on direct.

Mr. Levin: Let us go off the record a minute.

(Discussion off the record.)

Mr. Levin: Personally, I do not believe that the questions on direct indicated that Holly Molding Devices, Inc., was an Illinois corporation.

Mr. Fihe: The only thing that I desire to get from this witness at this time is whether or not he is willing to change his original direct testimony to the effect that Hollymatic Corporation was organized about October 1, 1946, and that its predecessor was Holly Molding Devices, Inc.

Q. (By Mr. Fihe): Are you still standing by that testimony, Mr. Wiscons?

A. I still say Hollymatic Corporation was formed October 1, 1946; but the predecessor was Holly Molding Devices of Chicago, or the name was used at that time. Right now I do not recall what it was.

Q. Will you agree with me that Holly Molding Devices, Inc., was incorporated about October 1, 1946, and that later—possibly sometime in 1948 or 1949, regarding which I know nothing—the name was changed to Hollymatic Corporation?

A. That is right, sir, but I still say Hollymatic Corporation was organized October 1, 1946; but

(Deposition of Frank H. Wiscons.)

that is the name we are using right now with just the name having been changed, no rules or anything else. [59]

Q. Now, we are both agreed that Holly Molding Devices, Inc. was organized about the first of October, 1946?

A. And then the name was later changed to Hollymatic Corporation—I will agree to that, sir.

Q. Now, what was the predecessor of Holly Molding Devices, Inc.?

A. Holly Molding Devices.

Q. What kind of organization was that?

A. A partnership, sir.

Q. Composed of whom?

A. Yourself, Albert J. Fihe, your wife, Harry Holly and his wife.

Q. Thank you.

I will show you another document, that I am marking for identification as Petitioner's Exhibit 2.

(Petitioner's Exhibit Number 2 was marked for identification.)

Q. (By Mr. Fihe): I will ask you read that, please.

(Document tendered.)

Q. Did you note the date of this document?

A. September 30, 1946.

Q. You were employed by the organization at that time, were you? A. I was, sir. [60]

Q. Did you ever see this document before or the original of it?

A. I do not believe that I have.

(Deposition of Frank H. Wiscons.)

Q. Now, do you happen to know how the partnership shares were distributed before the corporation was organized? A. No, sir.

Mr. Levin: There is an objection noted to the question and answer on the ground that this is cross examination and this field is not related to anything gone into or opened up on direct examination.

Q. (By Mr. Fihe): You testified on direct that, from an inspection of the books which you have here, when the corporation was organized it was capitalized at \$20,000; is that correct?

A. That is right, sir.

Q. And that at that time there was a surplus of \$12,000-some-odd dollars; is that right?

A. I believe it was \$12,698.28.

Q. Very good.

Now, you also testified that as of October 1, 1946, there was a liability account in the books charging me, Albert J. Fihe, with \$4,661.49, and charging my wife, Elizabeth M. Fihe, with \$3,461.29.

What do you know about that?

A. I know that it is not correct, because this is a [61] credit; it is not a charge.

Q. Now, when were these entries to which you have testified made?

A. I believe these entries were made when they got the C.P.A.'s to come into the office and try to gather up all the facts.

Q. About when was that?

A. You are pressing my memory, but I would

(Deposition of Frank H. Wiscons.)

say it was in the year 1948, but I will be dog-goned if I remember when.

Q. So that these entries, regarding which you testified and which appear in the books, which you have brought here for this purpose, were not made in those books at or upon the dates therein specified? A. What entries are you speaking of?

Q. All of them.

A. Oh, no, I wouldn't say all of them. The majority of the entries I have read were made at the time of entry. Those are the entries I read and about which I was questioned. They were made at the time of transaction—the journal entries.

I will agree with you some of them were picked up by the auditors, yes.

Q. Who did you testify had charge of the books in 1946? A. I recollect you did, Mr. Fihe.

Q. Did you have anything to do with the books in 1946?

A. Just as a matter of entering some figures on the [62] payroll account.

Q. You testified that you were purchasing agent at that time? A. Right.

Q. Did you have anything to do with payroll accounts? A. No, sir.

Q. Just at random, pick out any entry in the year 1946, regarding which you testified, and let me see it, please—anything.

A. All right, there you are (indicating).

Q. Do you recognize the handwriting?

A. I do.

(Deposition of Frank H. Wiscons.)

Q. Whose is it? A. Irene Jessen.

Q. Do you notice any disbursement to either me or Harry H. Holly during, say, this month of October, 1946?

Mr. Fihe: The witness pointed to some notations in the book.

Q. (By Mr. Fihe): Do they amount to more than \$50 at any time?

A. I have not studied the book that well, Mr. Fihe. These books were asked to be garnered two weeks ago, and I just picked them up and brought them down.

Q. Will you note that in practically all instances where checks were made payable to myself and Harry H. Holly, that [63] checks were also made payable to Agnes Holly, and my wife, Elizabeth M. Fihe? A. Not in all instances.

Q. I said "practically".

A. Practically—I guess, I wouldn't know.

Q. Can you tell me by looking at these books and particularly for the months of October and November of 1946, whether those disbursements included some payroll?

A. Those entries right there have to do with payroll.

Q. Can you tell me this: Whether A. J. Fihe, Harry H. Holly, Agnes Holly or Elizabeth M. Fihe were included in the payroll checks?

A. I can't tell you that; I do not know.

Q. You testified that during 1947, that salaries

(Deposition of Frank H. Wiscons.)

paid to me, Albert J. Fihe, as president of Holly Molding Devices, Inc., were \$25,920.

Mr. Levin: I object to that question. I believe, again, Mr. Wiscons' testimony was as to what the books showed; and he was just testifying as to what was in the books and records of Hollymatic Corporation or Holly Molding Devices, Inc.

Q. (By Mr. Fihe): Do you know for a fact, Mr. Wiscons, that I drew \$400 a week as president of the corporation, and no more?

A. No, sir, I am afraid I do not know that for a fact.

Q. Don't you know for a fact that Harry H. Holly drew [64] \$400 a week as vice-president of the corporation, and no more?

A. I wouldn't know that either, sir.

Q. You have the canceled checks showing that \$25,920, ostensibly, was paid to me during 1947?

A. I do not have them here, sir.

Q. Do you have them at all?

A. It is possible.

Q. Would you mind looking them up? I would like to see my endorsement on any checks over and above or in addition to the salary checks—52 of them at \$400 each.

Mr. Levin: Let the record show that the Respondent has not subpoenaed any cancelled checks from the corporation.

The Witness: I am not familiar with the books, Mr. Fihe. I cannot say anything about what is in the books.

(Deposition of Frank H. Wiscons.)

Mr. Levin: That is not responsive to the question.

Will you please read the last question?

(Record read.)

Mr. Levin: As a matter of fact, I do not believe there is a question pending. There was a statement rather than a question.

Mr. Fihe: I will now ask a question:

Q. (By Mr. Fihe): Mr. Wiscons, you have turned to one page of one of the books from which you have been testifying. I note that the heading on that page includes my name and what was then my [65] Chicago address.

Now, it happens to be for the year 1947 and runs from May 9 of that year to December 26 of that year. Do you see anything in there except records of \$400 per week payments to me as salary?

A. I see one entry made of \$800 on May 9.

Q. Do you know why that was \$800?

A. No, sir.

Q. All of the others are \$400; is that correct?

A. That is right, sir, except the last entry down here of \$11,920.

Q. Where did that come from?

A. I do not know that. I do not know.

Q. And that is in pencil, is it not?

A. That is right, sir.

Q. When was the sheet prepared from which you have been testifying?

A. I'd say back in 1947.

(Deposition of Frank H. Wiscons.)

Q. If I were to say there was no such book in 1947, would you believe me?

A. No, sir, that is my handwriting.

Q. And you made that in 1947? A. Yes.

Q. Whom did you say had charge of the books in 1947?

A. I said I had charge of the payroll records, or posting [66] of payroll records, and you had charge of the books, or Irene Jessen was posting but was told what to post. I think we had an auditor by the name of Mr. Bornstein who told her what to post.

If you are looking for Mr. Harry Holly's page, it is in the back.

Q. Right.

Now, referring to Mr. Holly's payroll account, his salary apparently started also on May 9, 1947, and that was \$800, is that right?

A. I would have to answer it, yes, that is right.

Q. After that it was \$400 a week for four weeks; is that right? A. Right.

Q. And then it dropped to \$200 a week. What was the reason for that?

Mr. Levin: To which I object. That has not been raised on direct examination and it is not proper subject for cross examination.

Mr. Fihe: You may answer, if you know.

The Witness: I'd rather not, because I do not know.

Q. (By Mr. Fihe): You do not know? It is your handwriting; isn't it? A. Yes, sir.

(Deposition of Frank H. Wiscons.)

Q. You do not know why his salary was cut to \$200 a week? [67]

A. I would rather not answer.

Q. You would rather not answer?

A. Yes.

Q. Do you know this is a deposition taken for The Tax Court of the United States, relating to tax matters, and the Tax Court is supposed to know everything in a proceeding such as this?

You know the answer, and I think you can tell me. Do you refuse to answer?

A. Yes, sir.

Q. Do you know that I can bring you into the Federal Court here and make you answer that question?

A. I do not know you could do that.

Mr. Levin: The Respondent wants the record to show that any refusal on the part of the witness to answer is not at the instigation or with the knowledge on the part of the Respondent.

I believe the questions are immaterial and irrelevant. However, the Respondent has not instructed nor does he instruct the witness not to answer.

Q. (By Mr. Fihe): Will you refer to the last accounts of the book entitled "Agnes Holly". Is it a fact that she went on the corporation payroll on June 16, 1947, at \$200 a week?

A. That is what it shows. [68]

Q. That was exactly the same time Mr. Holly's salary was cut to \$200 a week; is that correct?

A. Yes, sir.

(Deposition of Frank H. Wiscons.)

Q. And that state of affairs continued until November 21, 1947; is that right?

Mr. Levin: I object to the question on the ground of immateriality and on the ground that the question was not raised on direct examination.

Mr. Fihe: The witness has testified from these books. I do not want to burden the Court with the books, and I do not want to burden the corporation with the necessity of providing the books in court.

I do want to show what the records show, and I believe that the witness has admitted that that is what the records show.

Q. (By Mr. Fihe): Now, did you see Mr. Harry H. Holly around the offices of Holly Molding Devices, Inc., at any time between June 13, 1947, and November 21, 1947?

Mr. Levin: I object to the question on the ground it is immaterial and has nothing to do with the issues on trial.

Mr. Fihe: You can answer that question.

The Witness: I do not remember.

Q. (By Mr. Fihe): If I told you that Mr. Harry Holly was in the Federal [69] penitentiary serving a term for attempted income tax evasion during that period of time, would you agree that that was correct?

A. I would not agree on the time. I know he did, but I do not remember the time.

Q. Do you know Mr. Holly's signature?

A. Fairly well, sir.

Q. I show you four documents which I have

(Deposition of Frank H. Wiscons.)

marked for identification as Petitioner's Exhibits 3, 4, 5, and 6, respectively.

(Petitioner's Exhibits Numbers 3, 4, 5 and 6 were marked for identification.)

Q. I ask you to state if you recognize any of these signatures on those documents?

(Documents tendered.)

A. I am not a handwriting expert, but it does look like Harry's signature.

Q. You testified that there was a credit to me, Albert J. Fihe, in 1947 of \$10,706.20, according to the books which you have here before you.

Do you have any record that I ever got that money?

A. That account was cleaned up—Albert J. Fihe's account—on the date as to which he examined before and that amount was included in that group.

Q. What date are you talking about?

A. Your account was at zero balance as of January 31, 1948, and that figure of \$10,706.20 was credited to you on [70] April 30, 1947. That was merely a bookkeeping transaction.

Q. That is right, sir.

It was not done on April 30, 1947, either, was it?

A. I do not remember, sir.

Q. Now, you have testified that on March 31, 1947, I was debited in the amount of \$800; and you further testified that there was no explanation that you could give for that amount.

Mr. Levin: I object to that question. The witness

(Deposition of Frank H. Wiscons.)

was not testifying; he was just reciting what was in the books and records of the Hollymatic Corporation.

Q. (By Mr. Fihe): If I told you I never got that \$800, and there was no reason to charge me for that \$800, would you believe me?

Mr. Levin: I object to that question. I think it is being placed on a personal basis,——

The Witness: I wish you would not do that, Mr. Fihe.

Mr. Levin (Continuing): ——and I think the question should be to the witness as to whether or not he knows such facts occurred or whether the books so reflect, rather than trying to place it on a basis where he will be on the spot.

The Witness: According to the books, I stated a check was issued March 31, in the amount of \$800; and it was made payable to Albert J. *Fee* on March 17, with no explanation as to why it was drawn.

Q. (By Mr. Fihe): Do you have that cancelled check? A. I do not know.

Q. You also testified that there were some more checks apparently made payable to me, Albert J. Fihe, in the amount of \$700, another \$700, and \$2,325, dated April 30, 1947; and you further said there was no explanation for those checks.

Do you have those cancelled checks?

A. I do not know, sir.

Q. You further stated there was an item of \$3,000 on that same day, April 30, 1947, which an

(Deposition of Frank H. Wiscons.)

explanation that it was a loan to me from the corporation.

A. That is what the books say.

Q. You do not know anything about that yourself? A. No.

Q. If I told you I never got a nickle from the corporation in the way of a loan and all I ever did was lend them money, would you believe me?

Mr. Levin: I object to the question, on the ground that it is too personal and that it is not a question of getting a conclusion from the witness, but rather a question of what the facts are.

Q. (By Mr. Fihe): Would you care to answer that question?

A. I would not want to answer it.

Q. Do you know anything about the insurance loans we were [72] presumed to get from the company? There were some entries on that same fatal date of April 30, 1947, relating to some policy holders, Bureau Insurance loans.

Do you know for a fact that either Mr. Holly or I ever borrowed any money on insurance and charged that to the company?

A. I do not know that for a fact, no, sir.

Q. Now, there is an item here of rent, and it was apparently either charged or disbursed, depending upon whether it was mortgage or whether it was rent, to the four of us—Harry Holly, Agnes Holly, myself, Albert J. Fihe, and my wife.

Who owned that building upon which this rent was paid?

(Deposition of Frank H. Wiscons.)

A. Which building was that—the two-storied building or the smaller building?

Q. The one upon which rent was paid.

A. I presume the four of you owned that building. I presume that.

Q. Do you know when that building was bought?

A. No, sir. I do not.

Q. Do you know that that building was bought by a partnership consisting of the four of us?

A. No, sir, I do not.

Q. You testified that there was another item on that same date, April 30, 1947, totalling \$1,499.50, which was charged to the four of us and identified as unauthorized salaries. [73]

Do you not know for a fact that those were merely partnership withdrawals in the early part of 1946?

A. Don't I know that for a fact?

Q. I am asking you.

A. I do not know that answer.

Q. Now, there are some charges to me for some apparent payments on a patent purchase contract. Do you have the original or a copy of that alleged patent purchase contract?

A. I believe I have.

Mr. Levin: If you have——

Mr. Fihe: May I see it?

(Document tendered.)

Mr. Fihe: You have handed me a document which appears to be a carbon copy entitled, "Installment Purchase Agreement."

(Deposition of Frank H. Wiscons.)

Do you see any signatures on that document?

The Witness: Not on that one.

Q. (By Mr. Fihe): Do you have one with any signatures on it?

A. Not with me, sir, not here.

Q. Do you have it at all?

A. I do not have it, sir.

Q. Is it anywhere in existence that you know of?

A. Yes, sir.

Q. It is? A. Yes, sir. [74]

Q. Could you produce it for my inspection?

A. Not today any more.

Q. At some time convenient and satisfactory to both of us?

Mr. Levin: I object to this interchange. This is a legal action. We are not trying to work in some private inspections. The powers of subpoena are open to the Petitioner, and I think if he wants to subpoena the documents on his own, he can very well do so.

Q. (By Mr. Fihe): You testified regarding a charge to me on May 8, 1947, in the amount of \$2600.

Don't you know for a fact that that was money I gave Mr. Holly in order to assist him to pay his legal fees when he was defending himself or being indicted for an attempted income tax evasion?

A. I was not handling the books at that time. I do not know.

Q. Weren't you the comptroller in May of 1947?

(Deposition of Frank H. Wiscons.)

A. They gave me the title, but I did no accounting at the time. I believe that was the date—I do not know. I do not even know if that was the date.

Q. You also testified that June 30 of 1947, there was a charge against me in the amount of \$3,632.05 with no explanation whatsoever. [75]

Do you know whether I ever got that money?

A. The check was made payable to yourself, sir.

Q. Do you have the cancelled check with my endorsement? A. I do not know.

Q. You also testified that there was a charge to me of \$250 on September 30, 1947, and you stated that that was for insurance not for the company,—

Mr. Levin: I object.

Q. (By Mr. Fihe): (Continuing) —according to the books and records which you have here.

I show you a document which I shall mark for identification as Petitioner's Exhibit No. 7.

(Petitioner's Exhibit Number 7 was marked for identification.)

Q. Do you recognize the signature on that document?

A. It looks like Mr. Harry Holly's signature.

Mr. Fihe: Do you want to see that, Mr. Levin?
(Document tendered.)

Q. (By Mr. Fihe): You testified that there was a check made to me on December 19, 1947, which was an option payment in view of a contract whereby Mrs. Fihe and I would sell our stock.

Do you know how long that option was to hold?

(Deposition of Frank H. Wiscons.)

A. Will it be all right if I read it? I do not know [76] offhand.

Q. Take a look.

Mr. Levin: I will object to that question on the ground that the direct examination confined itself to the books and records and what appeared thereon; and that it is not a proper subject of cross examination.

The Witness: I do not know the answer to your question—I do not know.

Q. (By Mr. Fihe): If I told you that it expired in 30 days, and that I voluntarily allowed them to re-open, would you believe me?

Mr. Levin: I object to the question on the grounds heretofore stated. This has no bearing on the direct examination and is not a proper subject of cross examination.

Q. (By Mr. Fihe): Do you want to answer?

A. I would not know, Mr. Fihe.

Q. Now, there is a charge against me on approximately December 19, 1947, for \$2,292.36, and you admitted the books showed there was no explanation whatsoever.

Do you have that cancelled check with you?

A. Not with me, no, sir.

Q. Do you think you can find it?

A. It is possible.

Q. If I told you I never got that money, would you believe me? [77]

Mr. Levin: I object to the question on the ground it is too personal, and on the further ground

(Deposition of Frank H. Wiscons.)

that it has no bearing on the case as to what Mr. Wiscons believes. It is the facts that control.

Q. (By Mr. Fihe): I believe you testified that your records showed I was paid three weeks salary in the beginning of 1948 at \$400 a week, amounting to \$1200. Then you went on to testify that your records showed there was a further charge against me of \$981.90; and it was charged for salary.

Can you explain how—when I resigned as president of the corporation as of the first 3 weeks of 1948—how I drew any more salary after that, having completely severed my connection with the corporation?

A. I do not know how you could have drawn any more.

Q. You did testify that that check distinguished itself from the others, because there was no withholding or any other kind of tax deduction from it?

A. As I recall, that is right.

Q. And the first three had some withholding and some other tax deductions, and this had none. That is what you said; right?

A. Yes.

Q. You do not know what happened to the \$981?

A. Yes, sir, it was credited to your account.

Q. Did I ever get it?

A. When we closed out your account, it was included.

Q. If I told you I never got that, would you believe me?

Mr. Levin: To which I object on the ground that

(Deposition of Frank H. Wiscons.)

it is too personal in nature, not proper cross examination and the facts speak for themselves.

Q. (By Mr. Fihe): Let us talk about Mrs. Fihe's account: You testified way back in October 31, 1946, there was a \$300 charge to her account, but checks were issued to other people, including myself.

Would you agree with me that I owe my wife at least \$100 of that?

Mr. Levin: I object. That calls for a conclusion on the part of the witness.

The Witness: I would not answer.

Q. (By Mr. Fihe): As far as your books show, she never got that money, did she?

A. As far as the books show, that is true.

Q. She did not get it from me or either one of the Hollys? A. As far as the books show.

Q. There is another entry on October 30, 1946, which included \$1450 charged to her and, as you testified there were several entries of \$50, \$25, \$25, certain of which were apparently paid to me. In fact, five \$50 items. Will you agree with me [79] that I now owe my wife \$250?

Mr. Levin: I object to the question. It calls for a conclusion of the witness.

The Witness: I would not know you owed her, no.

Q. (By Mr. Fihe): As far as the books show, she never got it?

A. As far as the books, that is right.

(Deposition of Frank H. Wiscons.)

Q. She never got it from either one of the Hollys?
A. As far as the books go.

Q. Now, there is a debit to her on January 31, 1947, apparently a check issued on January 10 of that year in the amount of \$800. You admitted there was no explanation for it.

Do you have that cancelled check endorsed by her?
A. I do not know, sir.

Q. How about the one item of \$550, dated March 21, 1947, charged to her account on March 31, 1947?

Do you have that cancelled check?

A. I do not know.

Q. You stated that there was no explanation on the books for that amount, did you not?

A. I do not remember about that.

Q. If I tell you you did, will you believe me?

Mr. Levin: I object. The record will show what was said. [80]

Q. (By Mr. Fihe): Now, on April 30, 1947, there appears an entry on a check given me in the amount of \$1000, and \$700 of that was charged to me and \$300 charged to my wife.

Is there any explanation?
A. No, sir.

Q. Do you have those cancelled checks, endorsed by either one or both of us?

A. I might have.

Q. Would you mind trying to find them for me?

A. I will look.

Q. Do your records show I received any salary in 1946, either from the corporation or the partnership?

(Deposition of Frank H. Wiscons.)

A. Those records were not subpoenaed. I do not have them here with me.

Q. 1946?

A. I do not have them here with me.

Mr. Fihe: That is all of the cross examination.

Examination

Q. (By Mr. Levin): Just one item to clear up, Mr. Wiscons. I believe you testified that you had no explanation for \$11,920 appearing on the officer's salary ledger sheet for Mr. Albert J. Fihe; is that correct.

A. That is on the payroll account.

Q. On the payroll account; is that right?

A. Yes, sir. [81]

Q. Now, on direct examination you read into the record a journal entry of April 30, 1947, showing that item; is that right?

A. Yes, I have that item on April 30.

Q. That item is in the amount of how much?

A. \$10,706.20.

Q. Where was that posted from?

A. From our general journal.

Q. Would you again read the general journal item, please?

A. The general journal item reads, Journal No. 12, dated April 30, 1947, charging or debiting executive's salary \$23,840; credit above O.A.B. Tax—employee, \$85; credit employees' income taxes withheld, \$2444.60; credit Albert J. Fihe, \$10,706.20; credit Harry H. Holly, \$10,604.20. The explanation

(Deposition of Frank H. Wiscons.)

reads: to set up executives' salaries, accrued but not paid for 7 months ended April 30, 1947.

Q. Was that posted in the subsidiary ledger account showing the payroll? Was that posted in the subsidiary ledger account showing the salary to Albert J. Fihe for the year 1947?

A. It was, sir.

Examination

Q. (By Mr. Fihe): Your accountants made the entries, did they not?

A. Not the payroll entries.

Q. No, I mean that last thing—this \$11,000 in the ledger?

A. The accountants had, I believe, given us the entries [82] to make.

Q. And they are just in pencil at the bottom of that page?

A. On this one here (indicating).

Mr. Levin: Let us identify the book.

Mr. Fihe: I am talking about my own page with my name at the top showing payroll checks.

The Witness: That is my writing.

Q. (By Mr. Fihe): It is in pencil?

A. Yes.

Q. Who told you to do that?

A. It was set up from the general ledger book to the payroll book.

Q. Who told you to do that?

A. I would assume the accountants at that time. No one else knew anything about it, outside of yourself and Mr. Bornstein.

(Deposition of Frank H. Wiscons.)

Q. Who was the accountant?

A. Barrow, Wade & Guthrie.

Q. You mentioned Mr. Bornstein. He was your auditor in 1946 and early 1947, was he not?

A. If you can call him an auditor. He used to come in and check the books. I do not know.

Q. Don't you know he went to the penitentiary for attempted income tax evasion?

Mr. Levin: I object on the ground that the question [83] is immaterial and irrelevant.

The Witness: I believe I heard of it.

Mr. Fihe: That is all I have.

Mr. Levin: That is all.

(Which were all of the proceedings had in the above-entitled matter.)

/s/ FRANK H. WISCONS. [84]

[Endorsed]: T.C.U.S. October 28, 1955.

[Title of Tax Court and Docket Nos. 52394, 52396.]

TRANSCRIPT OF PROCEEDINGS

Court Room 9, U. S. Post Office and Court House Building, Los Angeles, California, November 28, 1955—2:00 p.m.

(Met, pursuant to notice.)

Before: Honorable Norman O. Tietjens, Judge.

Appearances: Albert J. Fihe, 1671 Casale Road, Pacific Palisades, California, appearing for and on

behalf of the Petitioners. Mark Townsend, Office of Commissioner of Internal Revenue, 1135 Subway Terminal Building, Los Angeles, California, appearing for and on behalf of the Respondent. [1]*

Proceedings

The Clerk: Docket Nos. 52394 and 52396, Albert J. Fihe and Elizabeth M. Fihe. Will you please state your appearances for the record?

Mr. Townsend: Mark Townsend, for the Respondent.

Mr. Fihe: Albert J. Fihe, for the Petitioners.

Mr. Townsend: Your Honor, I have a motion to amend the answer. Would you care for me to go into that at this time or after the opening statements?

The Court: After the opening statements.

Mr. Fihe: If the Court please, I understand that you would like at least a short opening statement so that you may be apprised of some of the facts upon which the Petitioner relies.

The Court: Well, that Mr. Fihe, and could you define the issues and see if there are some that can be resolved?

Opening Statement on Behalf of the Petitioners
by Mr. Fihe.

Mr. Fihe: It may sound something in the order of a story, but I believe that the Court will comprehend the facts upon which we are relying, if I just present it in the form of a story to start with. I am

* Page numbers appearing at top of page of Reporter's Original Transcript of Record.

a patent lawyer by profession and every once in a while, I have a client coming in who has some kind of an invention which looks as though it may have promise, and more often than not, the client has no money.

In some of these cases, I take it upon myself to try [3] to get the man a patent and help him promote the invention by manufacturing or selling or helping him by doing so.

In this particular case, it happened that in about 1936, this party, by the name of Harry Holly, came to me and he had invented a new machine for making hamburger patties for use in making the ordinary hamburger buns. It was a better machine, a better sanitary method, so I agreed with him to try to get him a patent and if it was fairly good, we would try to manufacture those machines and sell them. That was in 1936.

We went ahead with that and the patent application was allowed and looked good, so we entered into an agreement, a partnership, just he and I, and it was on a fifty-fifty basis, the partnership.

He was to do the work on the machine. He assigned a half interest in the patent to me and I agreed to put up \$1,000.00, rented a little place and got him started. Well, that \$1,000.00 did not last very long, and we will prove, your Honor, that during the next five years, Mrs. Fihe and I continued to put money into that business to keep it going because we still had some faith in it, and we put in about \$35,000.00.

We got the patent and for a long time it looked

as if we had nothing. We could not sell the machines. We could not even give them away. I know, because I tried myself. But finally they began to take hold and even then we did not make any money. It was a matter of putting even more money into it [4] and in 1940, 1941 and 1942, as we will prove, your Honor, we put additional sums, approximately about \$12,000.00 into that partnership, and at that time, your Honor, there were just the two of us, Harry Holly and myself.

However, as time went on, and as we will prove, my wife put quite a bit of her own money into that business, so on January 1, 1945, we organized a partnership which included Holly's wife, Agnes Holly and of course, my wife, Elizabeth M. Fihe.

That four party partnership continued until about October 1st of 1946, and we operated under the same name as originally used, namely, Holly Molding Devices and that molding was spelled "M-o-l-d-i-n-g". There had been some previous partners which doesn't mean much, because they were just limited partners, but when we organized the four party partnership, it was, as we will show, a bona fide partnership.

The Commissioner contends that it was not a partnership and that is the bone of contention. Another point in question is that we did not put into it that much money and we will try to prove that we did.

After the corporation was organized on October 1st, 1946, it went on for a while. I was president, Mrs. Fihe was treasurer, Harry Holly was vice

president and Agnes Holly, his wife, was secretary.

Then a disagreement occurred—that will probably [5] come up in the course of the trial—finally, we agreed to sell our interest in the stock and the sale of that was arranged, I think, about the 1st of March of 1948. I am just relying on my memory there. And we sold out for \$100,000.00.

Even then the company did not have much money and we took notes.

The Court: When you say you “sold out”, what do you mean?

Mr. Fihe: We sold our stock in the corporation, your Honor.

The Court: Stock?

Mr. Fihe: Yes. We got \$24,000.00 cash and my wife got about \$970.00 a month and I got about \$780.00 a month plus interest until the notes were all paid.

That point is another on which we are having quite a disagreement. The respondent here contends that in as much as Mrs. Fihe and I got \$24,000.00 cash when we sold our stock and that we then proceeded to get, starting I think on the 1st of March, about \$1,750.00 per month, that that consummated a complete sale during the year of 1948 and that, therefore, we were compelled to pay tax on that as a capital gain all in one year.

We shall prove, your Honor, that the notes which we obtained and which were payable in that year, payable to the individual and definitely omitted the words “or order”, “o-r [6] o-r-d-e-r”, and therefore, were not negotiable notes. Neither Mrs. Fihe

or I could have obtained one penny on those notes by trying to borrow on them. We did not because we knew we could not. We just hoped that they would be paid when they became due and which they were.

Now, that is another point which is here before the Court. Are we compelled to pay that tax on the capital gain all in one year, or is that tax to be paid as we collected the money, and in that connection, there is a correlary. The Government contends that we only put about \$20,000.00 into that business, for which we got \$100,000.00 when we sold out twelve years later.

We contend that, for the first seven or eight years, we continued to pour money into it and probably put almost \$50,000.00 into it. We contend reasonably that we invested \$35,000.00 in the first five years and that, therefore, we should not be taxed on more than a \$60,000.00 profit. And I believe that is reasonable.

You cannot make \$100,000.00 out of \$2,000.00 or \$10,000.00 or even \$20,000.00 in twelve years.

Then, as a point, regarding the actual returns, the usual contention is that we deducted too much for that and too much for this and too much in the way of contributions and too much in the way of medical expenses, and too much in the way of traveling expenses, advertising and so on. [7]

Now, I kept pretty fair books and I think we can substantiate practically all of those deductions and in that connection, your Honor, I went to Chicago, where we lived at that time, and came out here in

1948, after we sold out, I went to Chicago and took all my records. I shipped them there, practically a trunkful and worked with the Income Tax agents in Chicago, because the Holly books were there too, for one solid week. I was over there every day and they even began to think that I was on the payroll. And I worked with those gentlemen and I thought we had arrived at a very fair determination of the issues and agreed to it verbally, but then when the report came in a couple of months later, they had backtracked on a great deal of the items upon which I thought we had agreed, and upon which we had agreed verbally, and I wasn't very happy about that, and therefore this protest.

I believe that will give your Honor a fairly good idea of the question here presented and the rest of it will probably come out as we go along.

Opening Statement on Behalf of the Respondent
by Mr. Townsend.

Mr. Townsend: If the Court please, this proceeding involves deficiencies in income tax and negligence penalties for the years 1946, 1947 and 1948. The year 1949 is also involved, since there is a net operating loss carried back from that year to 1947. As Mr. Fihe said, some time in 1937, he and Mr. [8] Holly formed a partnership known as the "Holly Molding Devices" located in Chicago, Illinois, for the purpose of manufacturing hamburger molds.

Now, on or about September 25, 1946, the partnership was incorporated under the name of "Holly

Molding Devices, Inc.'" Now, all the assets and liabilities of the partnership were turned over to the corporation in exchange for capital stock, except for certain real estate and buildings which was apparently distributed to the individuals just prior to or at the same time, and were apparently rented by the individuals to the corporation.

Mr. Fihe was made the president of the corporation as he stated. In January of 1948, pursuant to an option agreement entered into during the previous month, Mr. and Mrs. Fihe sold all their interest in the corporation to the corporation. This interest consisted of capital stock, patent rights, land and a building.

He had actually received \$1,000.00 the previous month as a payment on the option and \$24,000.00 in January of 1947, so they received \$25,000.00 in cash, a credit of \$5,000.00 to Mr. Fihe's account, his personal account, offsetting a debit balance in that account plus two notes that they received totalling \$70,000.00 and a chattel mortgage securing these notes and covering all the machinery and equipment owned by the corporation. [9]

Payments of \$1,750.00 a month on the principal plus interest were made as Mr. Fihe mentioned, between he and his wife.

Now, early in 1948, Mr. and Mrs. Fihe moved to Los Angeles and established their home here. During all the years involved in this case, Mr. Fihe was engaged in the practice of patent law. He had apparently a law office in Chicago and also a law office in Los Angeles.

Also, in 1948 and thereafter, Mr. Fihe was engaged in the manufacturing business here in Los Angeles with his own factory which manufactured fishing equipment. Separate returns were filed by the Petitioners in 1946 but joint returns were filed for all the other years that are involved.

Now, the issues that are involved in this instant case on a year to year basis are as follows:

In 1946 we have the family partnership issue, in which the Respondent has not recognized Mrs. Fihe as a bona fide partner in the Holly Molding Devices partnership for the year 1946. That is the only year that she was involved, your Honor.

Further, in that year, Respondent determined that there was net income received from the Los Angeles law office rather than a loss as reported, and that deductions for legal expense and travel expense were overstated.

A carry back loss from 1948 was claimed by the [10] Petitioners or claimed by Mr. Fihe and was also eliminated due to a determination that 1948 was an income rather than a loss year.

In 1947 Respondent has determined that Petitioners understated income received from the Holly Molding Devices, Inc., by some \$10,000.00. The ninety day letter sets forth the understated income as representing dividends of some \$8,890.00 and royalties of \$1,166.57. The proof may show that this is a misnomer, as far as items are concerned, that is, that the understatement may consist of salary, dividends and/or royalties. The classification may be incorrect.

It is the Respondent's position, however, that the items represent income, regardless of their classification and Respondent requests the Court for leave to amend the pleadings to conform to the proof, as far as classification of these income items are concerned, if that is necessary to conform to the proof, as far as the mere classification of these items is concerned.

The remaining issues for that year are the partial disallowances of page 3 deductions claimed for contributions and taxes.

In 1948, the Respondent has determined that Petitioners understated income from the Holly Molding Devices, Inc., in the amount of \$861.90. Also in that year, some thirteen categories of business expenses were disallowed. An [11] addition of \$280.45 in receipts from law practice was determined. There was also partial disallowance of page 3 deductions claimed for contributions, casualty loss and medical expense.

There was also increased capital gains — an increase in capital gain. This comes about by the disallowance of losses claimed on the sale of personal residences and personal furniture; the inclusion of the full sales price received from the sale of stock, patent rights, land and building to the Holly Molding Devices, Inc., and a reduction in the basis claimed on such sale.

Mr. Fihe contends that he is entitled to either the deferred payment method or the installment payment method. I may state here that Mr. Fihe claims to have invested all this money in the partnership

since the assets and liabilities of the partnership were transferred to the corporation and loan accounts were set up by the corporation.

In other words, the corporation assumed the loss due to these Petitioners and apparently the outstanding liabilities were taken care of.

In 1949 the issues are the partial disallowance of some ten categories of business expense and the determination that receipts from law practice were understated.

Also, in that year, the disallowance of page 3 deductions claimed for contributions, taxes and interest. The [12] issue of negligence penalties is involved for 1946, 1947 and 1948. It is Respondent's position that the negligence penalties should attach in this case for the following reasons, your Honor.

As the proof will show, the Petitioners decided—deducted personal withholding taxes in 1947 as a page 3 deduction. That was over \$6,000.00 of those taxes that they deducted for personal expenses, such as moving expenses from Chicago to Los Angeles in 1948 as a business expense. Not only was this claimed as a business expense but it was claimed twice, once as freight expense and again as travel expense.

Mr. Fihe also deducted the cost of maintaining his family in a hotel after moving to Los Angeles in 1948 as travel expense of his business.

He deducted the losses sustained from the sale of two personal residences and furniture in 1948. He failed to report all the income received from the Holly Molding Devices, Inc.

He claimed duplicate deductions, including a deduction for taxes, in the amount of \$3,511.44 which was claimed as a page 3 deduction and also as a business expense on the 1949 return; also a deduction for interest in the amount of \$3,909.95 which was claimed as a page 3 deduction, and also as a business expense on the 1949 return.

And although he carried on a law practice in Chicago [13] and a law practice in Los Angeles and was also engaged in the manufacturing business, from which businesses large amounts of gross receipts were derived, Mr. Fihe failed to keep adequate or sufficient records of such businesses.

No books of account were maintained whatsoever. In fact, the only records were maintained on check book stubs and we have seen no accounts or books.

Mr. Fihe is an attorney with a large law practice and certainly cannot plead ignorance of the law as any mitigation or excuse of his negligence.

The Respondent would also like to point out with respect to the disallowance of expenses, that this is not a case where the expenses claimed have been disallowed in toto as unsubstantiated. In most instances the expenses claimed were allowed in part and the portions disallowed represented duplications, personal items, unallowable deductions, and a few unsubstantiated items.

In other words, there has been an audit in this case and Respondent has already applied the rule of the Cohan case.

Now, in Respondent's determination, Mr. and Mrs. Fihe reported in 1949 some \$21,000.00 as pro-

ceeds from the sale of their stock and other interests in the corporation. It is in compliance with this determination that the sale was completed in 1948 and eliminated from the report by the petitioners in 1949. The result of that elimination was a [14] net operating loss for that year which Respondent as allowed as a carry back to 1947.

Now, if the Court should determine that the Petitioners are correct in their contention, that they are entitled to deferred payment treatment or instalment payment treatment, that income should properly remain in 1949, which would have the effect of reducing or eliminating the net operating loss carry back to 1947 and would result in an increased deficiency for 1947.

It is purely a mathematical matter, but in order to protect itself and its interests, respondent would like to amend its pleadings to assert in the alternative that portion, that there would be an increased deficiency.

The Court: That is, in the event it should be decided that the Petitioner is allowed to defer payments. Have you any objection to that, Mr. Fihe?

Mr. Fihe: None, your Honor. I have no objection to the amendment.

The Court: The amendment will be received and if it necessary to file a——

Mr. Fihe: There are one or two points which counsel has mentioned. He stated that the records of Holly Molding Device show that I got \$10,000.00 that we never reported. I would like to say that I

would like to see that \$10,000.00 myself. We did not get it. [15]

He also stated that the records of Holly Molding Devices show that I received, in the first two or three weeks of 1948, \$861.00. I absolutely have no record of that. In fact, instead of getting \$100,000.00 when we sold out, the sum of \$5000.00 was arbitrarily taken on the basis that we owed the company some money, so we just lost \$5,000.00 in that deal.

But there was quite a bit of tension at that time and rather than have any more argument or fighting about it, we just waived our claim to what we should have had, that other \$5,000.00.

Now, as to our business expenses, I believe that an attorney moving his practice from one city to another is entitled to moving expenses. We made a complete move. We just pulled up our roots and moved out here. It cost me a lot to move out here. When we sold our property back there, we sustained losses and those losses are deductible.

The Court: You mean losses on personal residence property?

Mr. Fihe: Yes and of course, we sold what business property we had there but that was included in the transfer of the stock which was owned by the corporation. We sold our stock in that.

Now, if the Court please, I would like to ask Mrs. Fihe to take the stand and we will proceed with our proof, [16] your Honor.

The Court: All right.

The Clerk: Will you tell us your name, Mrs. Witness, please?

Mrs. Fihe: Elizabeth M. Fihe.

Whereupon,

ELIZABETH M. FIHE,

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Q. (By Mr. Fihe): You have stated your name as Elizabeth M. Fihe? A. Yes, I have.

Q. What is your residence address?

A. 1671 Casale Road, Pacific Palisades.

Q. How long have you resided in California?

A. Since August, 1948.

Q. Where was your residence in the years 1946 and 1947 and the first part of 1948?

A. In Chicago, Illinois.

Q. You are one of the petitioners in these two dockets, Nos. 52394 and 52396? A. Yes, I am.

Q. You are joined with me as your husband in these matters? A. Yes. [17]

Q. What was your occupation when you were living in Chicago from 1945 until approximately the beginning of the year 1949?

A. I was a partner in a business located in Chicago known as Holly Molding Devices.

Mr. Townsend: I move to strike the answer as a conclusion.

The Court: Objection sustained. May I have that answer read back, please?

(Testimony of Elizabeth M. Fihe.)

The Reporter: Yes, your Honor.

(Answer read.)

The Court: She gave her occupation as being a partner in the Holly Molding Devices. I think that would depend on the facts that you develop. It is a conclusion, Mr. Fihe.

Mr. Fihe: I don't know about that. She ought to know what she was doing in those years.

The Court: Well, whether or not a person is a partner would have to be shown by more than her own statement that she was a partner.

Mr. Fihe: Well, we will go a little further into the proof then.

Q. (By Mr. Fihe): Do you know what happened to the partners of the Holly Molding Devices in the year of 1946? [18]

A. I know it was incorporated in the State of Illinois, yes.

Q. And what was the name of the corporation?

A. Holly Molding Devices, Inc.

Q. Were you an officer in that company?

A. I was.

Q. What office did you hold?

A. Treasurer.

Q. And did you have any stock in that corporation?

A. Yes, I did.

Q. Do you know how many shares of stock were in the corporation?

A. There were two hundred shares of stock.

Q. Par value? A. \$100.00.

Q. How many shares did you own?

(Testimony of Elizabeth M. Fihe.)

A. Fifty shares.

Q. And how did you happen to own fifty shares of the stock in Holly Molding Devices Inc.?

A. Well, because I had invested money over a period of years in it.

Q. In what?

A. In the Holly Molding Devices, from the beginning, and continued on and I also——

Q. What was Holly Molding Devices? [19]

A. It was a partnership.

Q. Now, just what did you do when the partnership known as Holly Molding Devices was in existence—you, yourself—what did you do?

A. I, myself, worked in the business and my work consisted of checking the required supplies, ascertaining prices on various parts of machinery, ordering supplies, receiving orders for machines, seeing that they were properly billed and shipped, preparing the material to be distributed among the restaurant owners and restaurant supplies and I also attended various restaurant supply shows that were held in various cities of the United States, including New York, Chicago, and Boston.

Many of those shows lasted for ten days and went on from 11:00 in the morning until 11:00 at night.

Q. And what did you do at those shows?

A. I demonstrated the machine, talked to the restaurant owners about their problems, gave them descriptive literature, quoted prices to the distributors and gave general information concerning the molding machine.

(Testimony of Elizabeth M. Fihe.)

Q. How about that literature, was the only time you distributed literature while you were at these shows?

A. No, all during the time that I worked there, we circularized the restaurant owners through the United States, of which there are about sixty thousand and also answered [20] inquiries that came in after the receipt of this descriptive literature we had sent out to them.

Q. Who did that circularizing?

A. I did that.

Q. How? A. That was my work.

Q. How?

A. By mailing and typing the addresses on the outside of the envelope and enclosing the folders, sending it to the restaurant people, answering their inquiries as they came in.

Q. Now, getting back to the year 1936, tell what you know of our association with Mr. Harry Holly at that time please?

A. Well, I remember very well in 1936 that that was the year that the patent application was filed on the first molding machine, and at that time, we began to be interested in it. And then in 1937, the patent was issued and at that time Mr. Holly had absolutely no money and the patent was secured on the promise that if it materialized then we would help him finance and get started in the business.

So we rented a very small place where he was able to put up the machine and work and make further developments on it and during all that time we

(Testimony of Elizabeth M. Fihe.)

paid Mr. Holly—he had no money, so he started out on a salary of \$35.00 per week and he [21] worked on the machine and as we needed more equipment, we continued to put the money into it because it looked good to us.

Q. How long did that go on, as far as our putting money into that partnership is concerned?

A. That went on through the years, well, up until about 1940, and we put in on an average of \$8,000.00 or \$9,000.00 a year, the majority of which was my money.

Q. Do you remember about how much you put in personally over the years?

A. Well, it would be around \$35,000.00, I would say, \$30,000.00 to \$35,000.00.

Mr. Fihe: May I have this document marked as Petitioner's Exhibit No. 1, please?

The Clerk: Petitioner's Exhibit No. 1 for identification.

(The document above-referred to was marked Petitioner's Exhibit No. 1 for identification.)

Mr. Fihe: If the Court please, I would like to have the—strike that.

Q. (By Mr. Fihe): I show you a document which has been marked Petitioner's Exhibit No. 1 for identification—

Mr. Fihe: How far were we with this question? Will you read it, please? [22]

The Reporter: Yes, sir.

(Question read.)

(Testimony of Elizabeth M. Fihe.)

Q. (By Mr. Fihe): And I will ask you to state what that is, please.

A. That is a report from Dun & Bradstreet of the date of June 7, 1949.

Mr. Fihe: Would your Honor like to see that?

Q. (By Mr. Fihe): You have read that?

A. Yes.

Q. Would you state that it is substantially correct?

A. Yes, I would say it was substantially correct.

Mr. Fihe: Now, will you refer to—pardon me, if the Court please—to the second paragraph under the heading marked “History” and if the Court please, I would like to have that read into the record.

Mr. Townsend: Respondent objects to the question on the ground that the witness is testifying from a document which has not yet been introduced in evidence.

Mr. Fihe: I shall now offer the document, Petitioner’s Exhibit No. 1 in evidence.

Mr. Townsend: The next objection to the document is your purpose of the offer to prove the facts stated in that document, Mr. Fihe?

Mr. Fihe: Exactly. [23]

Mr. Townsend: The Respondent objects on the grounds that it is hearsay.

The Court: Objection sustained.

Mr. Fihe: I would like to point out, if the Court please, that that is a Dun & Bradstreet report which reports are recognized by businesses through-

(Testimony of Elizabeth M. Fihe.)

out the country and indeed, throughout the world, and I do not believe there is any better proof of our records than just those Dun & Bradstreet reports, in addition to the testimony of course.

How else can we prove it. It is a Dun & Bradstreet report on the business. They know what they are talking about. They cannot afford to put out false or misleading or wrong reports.

The Court: Those reports are based on information that is furnished them by the corporation, the concern about which the report is being written.

Mr. Fihe: That is correct, and the people who are officers of the corporation certainly know the history of the corporation.

The Court: Well, you have no officer here on the stand. I think your evidence is better than Dun & Bradstreet.

Mr. Fihe: My wife has already testified, of course, that it is substantially correct.

The Court: Well, I would rather have her testify as to those reports. [24]

Mr. Fihe: As to those reports?

The Court: As to those accounts.

Mr. Fihe: She was the treasurer of the corporation, your Honor.

The Court: The objection is sustained. Now, if you want to question her and develop those facts from her so that she will be subject to cross examination, you may continue, Mr. Fihe.

Mr. Fihe: Thank you, sir.

Q. (By Mr. Fihe): Could you—in order to re-

(Testimony of Elizabeth M. Fihe.)

fresh your memory, will you please read the first two paragraphs of this report?

Mr. Townsend: I hate to delay the proceedings here but I do not think there has been any showing that she does not have any recollection.

Mr. Fihe: There are some dates there, your Honor, which would assist her.

The Court: She may look at it.

Q. (By Mr. Fihe): Now, will you please state of your own personal knowledge as to when the four party partnership known as Holly Molding Devices was organized?

A. Approximately in January, 1945.

Q. And who——

Mr. Townsend: The Respondent moves to strike that [25] answer on the ground that the question includes a conclusion there?

Mr. Fihe: She is stating of her own knowledge.

Mr. Townsend: But the very thing that it is an issue before this Court is whether there was a four party partnership.

The Court: I will sustain that request to have the answer stricken and I wish you would develop from this witness exactly what happened around that date and what the facts were but not what the ultimate conclusion was from these facts, Mr. Fihe.

Mr. Fihe: Thank you, your Honor.

Q. (By Mr. Fihe): You were telling the Court about the origination of the original partnership composed of Harry H. Holly and myself back in

(Testimony of Elizabeth M. Fihe.)

1936 and you also told the Court as to your various activities in connection with that partnership.

Now, will you please tell the Court just how long that two party partnership continued?

Mr. Townsend: Your Honor, that is just saying the same thing in a different way.

The Court: Well, if the only testimony is going to be conclusions, I will have to draw my own conclusion.

The Witness: The two party partnership continued on until about 1945. [26]

Q. (By Mr. Fihe): Then what happened?

A. Then in 1945 in as much as we had put considerable money into it and I had worked out there as much as I did, that it was decided that we should each have an equal interest in the business, and in order to do that we were given each a quarter interest in it.

Q. Who were those people that got a quarter interest in it?

A. Harry Holly, Agnes Holly, Albert J. Fihe and Elizabeth M. Fihe.

Q. And how long did that partnership continue in existence?

A. Until September, 1946.

Q. And then what happened?

A. Then the business was incorporated.

The Court: Mrs. Fihe, when you say "we were each given a quarter interest," well, what took place?

The Witness: We entered into an agreement, the

(Testimony of Elizabeth M. Fihe.)

four of us, Harry Holly, Agnes Holly, Albert J. Fihe and Elizabeth M. Fihe.

The Court: Was it a written agreement?

The Witness: I think it was a written agreement. We all sat down together and said, "We have worked and you have worked and we have put money in and you have developed the [27] machine, so that we all ought to have an equal interest in it."

The Court: Is there a copy of that agreement available?

The Witness: The copy of it should be available at the headquarters some place. It was executed, I am sure.

The Court: You may proceed.

Mr. Fihe: I shall ask the clerk to mark this document as Petitioner's Exhibit No. 2 for identification.

(The document above-referred to was marked Petitioner's Exhibit No. 2 for identification.)

Q. (By Mr. Fihe): I show you another document which has been marked for identification as Petitioner's Exhibit No. 2 for identification, and I will ask you to state if you recognize that.

A. Yes.

Q. What is it?

A. This is a subscription agreement.

Q. Are there any signatures on it?

A. There are no signatures on this as it is a copy.

Q. Do you remember ever signing that?

(Testimony of Elizabeth M. Fihe.)

A. Yes.

Q. The original? A. Yes, I signed it.

Mr. Fihe: I will now offer Petitioner's Exhibit No. 2 [28] in evidence.

Mr. Townsend: I have no objection, your Honor.

The Court: Admitted.

(The document heretofore marked Petitioner's Exhibit No. 2 was received in evidence.)

Mr. Fihe: If the Court please, I would like to keep all the exhibits marked by the numbers in which I designated them rather than the exhibits which are received. If that procedure isn't approved by the Court, I will be glad to change the numbers.

The Court: Do you have any objection to that, Mr. Townsend?

Mr. Townsend: No, I don't.

Mr. Fihe: Otherwise the record might be confusing later on.

The Clerk: This is Exhibit No. 2?

Mr. Fihe: Yes.

The Court: What has become of the original of those exhibits?

Mr. Fihe: I am just going to ask the witness that question but if the Court please, I would like to have you look at it.

The Court: All right.

Mr. Fihe: Does the Court keep custody of that, your Honor? [29]

The Court: Yes, when you are through with it, Mr. Fihe.

Mr. Fihe: Yes.

(Testimony of Elizabeth M. Fihe.)

Q. (By Mr. Fihe): Do you remember who signed the original of that document?

A. Harry Holly, Agnes Holly, Albert J. Fihe, and Elizabeth M. Fihe.

Q. And do you know where the original is?

A. In the offices of the Holly Molding Devices, as far as I know.

Q. In what city? A. Chicago, Illinois.

Mr. Fihe: With all due reference to the objections of counsel and the Court's ruling, I have, with all due respect may I say, rather than reference, I will ask the Clerk to mark this document for identification as Petitioner's Exhibit No. 9.

(The document above-referred to was marked for identification as Petitioner's Exhibit No. 9.)

Mr. Fihe: May I explain at this time that there were depositions taken in this case in Chicago and in those depositions there were some exhibits and they were just marked for identification.

Now, unless we adhere to the particular numerical [30] order here, there will be some more difficulty, so with the Court's permission, may I sort of jump around in some part of these exhibits, but it will eventually prove out more coherent than if we started out with one here and started to get into these depositions as exhibits.

The Court: I do not have any objection so long as the record is clear as to what we are talking about.

The Clerk: That has already been marked for identification as Petitioner's Exhibit No. 9.

(Testimony of Elizabeth M. Fihe.)

Q. (By Mr. Fihe): And now, in order to refresh your memory—oh, I will show you this Mr. Townsend—have you seen it?

Mr. Townsend: No, I did not see it.

Mr. Fihe: Oh, I am sorry.

Q. (By Mr. Fihe): I will ask you to kindly look at this document marked Petitioner's Exhibit No. 9 for identification and I will ask you to refer particularly to the last paragraph on the last page, and ask you if that amount stated as \$85,750.00 which we were supposed to obtain for our interest when we sold out, is substantially correct?

Mr. Townsend: Respondent objects to the question on the grounds that the witness is testifying from a document that has not been introduced in evidence.

The Court: Well, I am going to take her statement [31] as being based on her own knowledge, rather than on the document.

Mr. Fihe: I am now offering the document in evidence as Petitioner's Exhibit No. 9.

Mr. Townsend: Respondent objects to the document on the ground that it is hearsay.

The Court: Objection sustained.

Mr. Fihe: May I again point out for the record, if the Court please, that this is an authentic Dun & Bradstreet report, which reports are generally accepted, at least, commercially and I believe, by the Courts.

The Court: I think the basis is for extending credit but as to the absolute veracity of the figures

(Testimony of Elizabeth M. Fihe.)

included therein, I think they are subject to objection. The Court could be wrong.

Mr. Fihe: I will now ask the Clerk to mark this document as Petitioner's Exhibit No. 7 for identification.

(The document above-referred to was marked Petitioner's Exhibit No. 7 for identification.)

Q. (By Mr. Fihe): I show you now what appears to be an original document which has been marked for identification as Petitioner's Exhibit No. 7 and I will ask you to state if you recognize the signatures on that document?

A. I do recognize them. [32]

Q. Whose are they?

A. Albert J. Fihe, Elizabeth M. Fihe, Harry Holly and Agnes Holly.

Mr. Fihe: Would you like to look at that, your Honor?

The Court: All right.

Q. (By Mr. Fihe): What is that document?

A. This is a deed conveying a piece of property from the partnership to the new owner.

Mr. Fihe: I offer the same in evidence as Petitioner's Exhibit No. 7.

Mr. Townsend: Respondent objects to the document. It has not been notarized. It isn't under seal and respondent objects to it on the grounds of genuineness.

The Court: The objection is overruled and I will accept it for what it purports to be. It isn't

(Testimony of Elizabeth M. Fihe.)

under seal—I don't know what effect that would have.

(The document heretofore marked Petitioner's Exhibit No. 7 was received in evidence.)

The Court: Was that document delivered to any one, Mrs. Fihe?

The Witness: Yes, your Honor.

The Court: To whom was it delivered?

The Witness: To the owner at one time. [32-A]

The Court: Who do you mean by "the owner" now, Mrs. Fihe?

The Witness: To us.

Mr. Fihe: From us.

The Witness: From us to the new buyer.

The Court: To the corporation?

The Witness: To the man whose name is on there.

Mr. Fihe: Yes, to Edwin——

The Witness: Edwin F. Zukowski.

The Court: How does it happen you have the document rather than he?

The Witness: It was probably purchased back later.

Mr. Fihe: I have a little more knowledge of that, your Honor, and I intend to ask the Court to swear me as a witness later on. I want to do a little testifying myself and I could then bring out some more pertinent facts about that particular document.

My wife could possibly tell you if she could

(Testimony of Elizabeth M. Fihe.)

think back just a little bit as to what actually happened at that time.

Off the record.

The Court: Off the record.

(Discussion off the record.)

Mr. Fihe: May it then be stipulated that the [33] photostatic copies of the particular papers which I am about to offer, be received in evidence with the same force and effect as the originals?

Mr. Townsend: Absolutely, no objection, so stipulated.

Mr. Fihe: I will now hand the Clerk a series of documents which I will ask him to mark for identification as Petitioner's Exhibits.

The Court: Well, now, let us see if we can dispense with that. Is there going to be any objection to the introduction of these into evidence, Mr. Townsend?

Mr. Townsend: I would like to have them identified, your Honor.

The Court: All right.

The Clerk: Is that one exhibit, sir?

Mr. Fihe: No, if you please, this is Exhibit No. 3.

The Clerk: Exhibit No. 3.

Mr. Fihe: Yes and 4.

The Clerk: 4.

Mr. Fihe: The next one is 5; the next one is 6 and the next one is 10.

The Clerk: 10.

Mr. Fihe: Yes, 10, if you please. [34]

(Testimony of Elizabeth M. Fihe.)

(The documents above-referred to were marked Petitioner's Exhibits Nos. 3, 4, 5, 6 and 10, respectively, for identification.)

Q. (By Mr. Fihe): I will ask you to state if you recognize the signatures on those documents?

A. Yes, I recognize the signatures.

Q. Whose are they?

A. Albert J. Fihe and Harry H. Holly.

Q. Just for the record, will you identify the dates and the amounts of those documents which are signed by Mr. Holly and myself.

A. One is——

Q. Petitioner's Exhibit No.—— A. 3——

Q. That is right.

A. ——is a note dated July 1, 1940, in the amount of \$4,511.56 payable to the order of Albert J. Fihe.

Q. Signed on behalf of——

A. Signed on behalf of Holly Molding Devices.

Q. Then what was Holly Molding Devices at the date of that note?

A. It was a partnership.

Q. Composed of?

A. Composed of Albert J. Fihe and Harry Holly. [35]

Q. How about the next exhibit, please?

A. Exhibit No. 4 is dated July 1, 1940, in the amount of \$3,590.67 payable to the order of Albert J. Fihe.

Q. Signed by?

(Testimony of Elizabeth M. Fihe.)

A. Signed by Albert J. Fihe and Harry Holly on behalf of Holly Molding Devices.

Q. And the next one, please?

A. Exhibit No. 5 dated December 3, 1940, in the amount of \$600.00.

Q. Is it signed by the same parties?

A. By the same parties payable to Albert J. Fihe, Holly Molding Devices, signed by Albert J. Fihe and Harry Holly.

Q. No. 6?

A. Is a note dated February 13, 1942, in the amount of \$988.85, payable to the order of Albert J. Fihe, signed by Albert J. Fihe and Harry Holly for Holly Molding Devices.

Q. And Exhibit No. 10, if you please?

A. And Exhibit No. 10 is a note dated July 1, 1940, in the amount of \$3,033.28 payable to the order of Albert J. Fihe, signed by Albert J. Fihe and Harry Holly, Harry H. Holly, for Holly Molding Devices.

Q. Now, will you please refer to Petitioner's Exhibit No. 10 and tell the Court, if you can, as to just what payments, if any, were made on the notes? [36]

The Court: Well, now, that will speak for itself, will it not, Mr. Fihe?

Mr. Fihe: That is true, your Honor.

I offer the photostatic copies of these notes in evidence as Petitioner's Exhibits Nos. 3, 4, 5, 6 and 10, respectively.

Mr. Townsend: No objection.

(Testimony of Elizabeth M. Fihe.)

The Court: Admitted.

(The documents heretofore marked Petitioner's Exhibits Nos. 3, 4, 5, 6 and 10, respectively, were received in evidence.)

Q. (By Mr. Fihe): Tell the Court, if you know, whether I or you even got all the money represented by those notes? A. No, we did not.

Q. Tell the Court, if you know, whether those notes represent all the money we put into that business? A. It doesn't.

Mr. Fihe: I will now ask the Clerk to mark this document for identification as Petitioner's Exhibit No. 8.

The Clerk: No. 8.

(The document above-referred to was marked Petitioner's Exhibit No. 8 for identification.)

Q. (By Mr. Fihe): I now show you a document which has been marked for [37] identification as Petitioner's Exhibit No. 8—do you think we could have a recess now, your Honor?

The Court: We will take a ten minute recess.

Mr. Fihe: Thank you, your Honor.

(Short recess taken.)

The Clerk: The Court is in session.

Mr. Fihe: Mr. Townsend, did you give me a copy of your amended——

Mr. Townsend: It is over on your desk.

Mr. Fihe: Oh, yes, thank you.

Will you read the last question which I started to ask—I think it was with reference to Exhibit No. 8?

(Testimony of Elizabeth M. Fihe.)

The Reporter: Yes, sir.

(Question read.)

Q. (By Mr. Fihe): I will ask you to state what that is, please?

A. This is a copy of the minutes of the first meeting of the Holly Molding Devices, Inc.

Q. And when was that, please?

A. That was in September, 1946.

Q. Where is the original of that document, if you know?

A. It was in the offices of the Holly Molding Devices in Chicago.

Q. Will you tell the Court whether you remember signing [38] the original of that document?

A. I do.

Q. Who else signed it?

A. Albert J. Fihe, Harry H. Holly and Agnes Holly.

Q. Will you tell the Court whether you actually received shares of stock in Holly Molding Devices, Inc., a corporation? A. Yes, I——

Q. Pursuant to the plan set forth in this document, Petitioner's Exhibit No. 8?

A. Yes, I did.

Mr. Fihe: I offer the document in evidence as Petitioner's Exhibit No. 8.

Mr. Townsend: May I ask a question on it, your Honor?

The Court: Yes.

Mr. Townsend: How did you secure that copy, Mrs. Fihe, or when did you secure that copy?

(Testimony of Elizabeth M. Fihe.)

The Witness: My husband is the one who could tell you that.

Mr. Townsend: How do you know that that is an accurate copy of the minutes?

The Witness: Because I saw the original.

Mr. Townsend: That is what I mean.

The Witness: I saw the original at the time it was signed. [39]

Mr. Townsend: And you received this copy at that time?

The Witness: I don't know.

The Court: Well, there is no evidence that she received it but she identified it as being a copy.

Mr. Townsend: I have no objection.

The Court: It is received, as Petitioner's Exhibit No. 8.

(The document heretofore marked Petitioner's Exhibit No. 8 was received in evidence.)

Q. (By Mr. Fihe): What did you finally do with the stock of that corporation that you received at that time, in September of 1946?

A. I sold the stock.

Q. And I believe you have already testified, refreshing your memory from one of these Dun & Bradstreet reports, that we, you and I, have received, for our stock, \$85,750.00 and that you remember that; is that correct? A. Yes.

Q. How was that paid to us?

A. Well, originally we received a payment of \$25,000.00. Then——

The Court: Cash, you mean?

(Testimony of Elizabeth M. Fihe.)

The Witness: Yes, your Honor. Then I received [40] \$970.00 a month plus interest and you received \$780.00 a month plus interest for the balance of \$85,000.00.

Q. (By Mr. Fihe): Could you tell why you got a little more than I did?

A. Because I put more money into the business originally.

Mr. Fihe: You may cross examine.

Cross Examination

Q. (By Mr. Townsend): Mrs. Fihe, would you tell me where you lived prior to moving to Chicago? A. In Chicago, Illinois.

Q. Prior to moving to Chicago?

A. Oh, my, that was so long ago. It was Preston, Minnesota.

Q. Preston, Minnesota? A. Yes.

Q. Did you ever live in Indiana during part—

A. Yes, during part of the year.

Q. Where was that located in Indiana?

A. It was Dune Acres, two words, D-u-n-e A-c-r-e-s. However, our voting address was Chicago, Illinois.

Q. Was that in Chesterton?

A. That was the post office, we received our mail there. [41]

Q. Where did you live exactly in Chicago, do you recall that? A. During what time?

Q. Oh, during the period 1947 to 1948.

(Testimony of Elizabeth M. Fihe.)

A. 1947 to 1948, we lived at 179 Lakeshore Drive.

Q. Was that a cooperative apartment?

A. Yes.

Q. Do you recall when you sold that apartment?

A. Well, it was prior to our coming out here. I would say it was probably July of 1948.

Q. And your home at Chesterton, Indiana, do you recall when you sold that; was that at about the same time?

A. That was subsequent thereto.

Q. Was it in the same year, Mrs. Fihe?

A. Yes. Well, I am not sure about that. It may have been January of the next year. It was either late one year or early the next year.

Q. When you sold your apartment at 179 Lakeshore Drive, did you also sell your furniture or some of your furniture at that time?

A. Well, maybe part of it—some of it, yes.

Q. Now, when you spoke about selling your shares of stock in the corporation, when did you sell those shares?

A. Approximately the spring of 1948.

Q. And who did you sell them to? [42]

A. To the corporation, Holly Molding Devices, Inc.

Q. Are you familiar with the records that your husband has kept and which he has brought into Court today, the check book stubs?

A. No, I am not.

Q. You are not at all familiar with those?

(Testimony of Elizabeth M. Fihe.)

A. No.

Mr. Townsend: Could I use them, please?

Mr. Fihe: Yes.

Q. (By Mr. Townsend): Are you familiar at all with this book that I am showing you now, Mrs. Fihe? A. Yes, sure, I have seen it.

Q. Will you tell me what it is, please?

A. You mean what I think it is?

Q. Yes.

A. Well, I think it is the stubs from my husband's check book.

Q. Now, I turn to an entry therein which is dated May 29, 1947, and ask you to read that, if you would please, Mrs. Fihe?

The Court: You mean aloud?

Mr. Townsend: Yes, aloud.

The Witness: 49 shares of Holly stock \$4,900.00.

Q. (By Mr. Townsend): Now, you note the date on that, Mrs. Fihe, is in May, 1947?

A. Where is the date again?

Q. Here is the month, the day and the year.

A. Yes, I see that. What is it you want to know?

Q. Well, that would indicate——

A. I am not qualified to make any comment on that.

Q. You don't recall anything about selling any shares in 1947?

A. I don't know anything about that.

Q. But you did not sell any shares in 1947?

(Testimony of Elizabeth M. Fihe.)

A. Well, not to my recollection. I may be wrong on the date.

Q. Now, when you advanced money to the partnership and to the corporation, did you receive notes for your advances, Mrs. Fihe?

A. In the beginning we received nothing for the reason that it started out very simply like so many things do and it kept accumulating and it kept accumulating until it got to be too much that we did not get any notes until roundabout in 1940.

In these early years, we had no notes. But the demands continued to get larger and larger and in 1940, we asked for notes. I did, because I felt I could not put more into it [44] without having something definite to show for it, although we trusted Mr. Holly.

Q. Sure. Now, you ascertained a figure that you put into the partnership; what is your basis for that estimate, Mrs. Fihe?

A. Well, from what amounts I had available to do something with in those years.

Q. Before coming to California, did you check something to find out what you had available in those years?

A. Oh, not now. I knew about that some time back. It made a great impression on me because I was going into something I had never gone into before.

Q. From where did you receive your money?

Mr. Fihe: Objection, your Honor. That is absolutely immaterial.

(Testimony of Elizabeth M. Fihe.)

The Court: Objection overruled.

The Witness: Shall I answer, your Honor?

The Court: Yes.

The Witness: I had worked previously and made a very good salary and kept my money because my husband supported the family and made the agreement with me that I could keep my money or do anything with it I wanted to. I was earning a very much larger salary than most women received in those days. [45]

Q. (By Mr. Townsend): How long did you work in that business?

A. How long did I work there?

Q. Yes, the years.

A. Well, it began around about 1926 and went on intermittently up to 1927, 1928, 1929 and on at various times although there were times intervening when I wasn't earning, but on and off, beginning in 1926.

Q. And ending roughly when, Mrs. Fihe?

A. Well, let me see, probably around 1942 or 1943 or something like that.

Q. 1942 or 1943? A. Yes.

Q. So that you did have outside employment at the time that you were—at the time the partnership was in operation? A. Yes, off and on.

Q. Could you tell me roughly what your salary would average in this outside work?

A. Well, \$5,000.00 to \$6,000.00 a year probably.

Q. And what type of work did you do, Mrs. Fihe?

(Testimony of Elizabeth M. Fihe.)

A. Well, I did social service work connected with the Courts, head of various social service departments.

Q. Now, do you recall how many days you worked say in 1946, for the partnership, Holly Molding Devices?

A. Oh, it would be very difficult to tell you exactly. [46]

Q. I mean before the partnership; did you go down there every day? A. Oh, yes.

Q. Did you have your own office down there?

A. Yes, there were offices set out that we occupied.

Q. And did you go down there every day?

A. Yes.

Q. During 1946? A. Yes, I did.

Q. How about Agnes Holly, was she also down there every day?

A. Well, I saw her on and off at various times. I was there a lot of times in the evenings too. I went there nights as well as days.

Mr. Townsend: I believe that is all, your Honor.

Mr. Fihe: If the Court please, I have made a resume——

The Court: Are you finished with Mrs. Fihe?

Mr. Fihe: Yes, I think so.

The Court: You are excused. Thank you.

(Witness excused.)

Mr. Fihe: I have made a resume of the amounts of money shown on our books which we received from Holly Molding Devices, either the partner-

ship or the corporation in 1946, 1947, 1948 and 1949. [47]

The Court: When you say "we", do you mean your wife and you?

Mr. Fihe: That is correct, your Honor. And I would like to offer that resume as one exhibit, Petitioner's Exhibit No. 11—is it, Mr. Clerk?

The Clerk: That is correct.

(The document above-referred to was marked Petitioner's Exhibit No. 11 for identification.)

Mr. Fihe: I might explain that in this resume, I have indicated money received by me as of the dates shown and my initials, and money received by Mrs. Fihe, as of the date shown and her initials and when it was definitely salary I have so marked it.

On occasions we would get some money back on our loan account as evidenced by the notes which are here in evidence and that is also marked.

I think offering this as an exhibit, as one exhibit, will suffice if the Clerk will so mark it, please.

The Clerk: It has been marked for identification as Petitioner's Exhibit No. 11.

Mr. Townsend: Are you offering it?

Mr. Fihe: Yes.

Mr. Townsend: Your Honor, in the first place, I would have to check this exhibit against the records of Mr. Fihe which consist of the check book stubs here in the room. [48] I have done so and this record does contain a good many of the items as shown in his check book records as cash received. However, there are also a number of items

that have been omitted from that exhibit, and I would also like to point out that the figures on there are misleading to some extent, in that they are net figures, which actually if that was solely a cash receipt schedule, it would be correct.

The payments are net after tax has been taken out. But when he gets into the latter part of it here, when he has omitted some cash received on the grounds that it isn't income in his opinion, therefore, I do object to the exhibit for that reason that it isn't truly a cash received schedule and even his own records show additional cash received from that.

Possibly we can do that by reading into the record the items which are not included in this list and take it in the form of a stipulation, rather than an exhibit.

Mr. Fihe: I had planned to ask the Court to swear me and I will clearly testify about those points which I believe would probably bear it out better than in any other way.

Mr. Townsend: At this time I would have to object to the exhibit on the grounds that I do not think Mr. Fihe is qualified to prepare this exhibit.

I would be happy to stipulate to that exhibit if the omissions were mentioned.

The Court: How do you intend to do that? [49]

Mr. Townsend: I would read the omissions into the record and perhaps Mr. Fihe will stipulate to that.

The Court: Can counsel get together and see if you agree on that?

Mr. Fihe: We can stipulate after we get together on them. I am sure we can do that.

The Court: How long would it take? Supposing I gave you a short recess and see if you can get together on it?

Mr. Fihe: I think we could do it in fifteen to twenty minutes.

Mr. Townsend: Possibly less than that, your Honor.

The Court: All right, we will recess and you can get together on it.

Mr. Fihe: Thank you, your Honor.

(Short recess taken.)

The Clerk: The Court is in session.

Mr. Townsend: Your Honor, I think the parties can stipulate to Petitioner's Exhibit No. 11, to the effect that it represents the amounts received in cash by Mr. and Mrs. Fihe per their check book records here as indicated thereon with the exception that the following amounts have not been included on this list.

Mr. Fihe: May I interrupt at this moment, please, your Honor? As part of the stipulation, may it also be [50] stipulated that this check stub book represents a joint account of Mrs. Fihe and myself?

The Court: Is that agreeable, Mr. Townsend?

Mr. Townsend: It apparently is, your Honor. It looks that way. Deposits for both are received thereon.

The Court: All right, proceed.

Mr. Townsend: The first item is February 13, 1946, there is an entry in the record of tax \$601.75

interest and penalty of \$169.68, representing tax for 1941, which is paid by a check by the Holly Molding Device——

Mr. Fihe: On behalf of Albert J. Fihe.

Mr. Townsend: Right.

Mr. Fihe: And that is so stipulated, your Honor.

Mr. Townsend: The next entry is on March 14, 1946. There is the receipt of \$300.00 for the sale of an automobile from Mr. Fihe to the partnership.

Mr. Fihe: That is also so stipulated, but I would like to reserve an opportunity to show that there was a loss on that sale. I do not believe I claimed any loss at the time I turned in my return at that time.

Mr. Townsend: And on August 21, 1947, there is a receipt of \$150.00 from Holly Molding Devices as a refund on motors.

Mr. Fihe: May we stipulate there that out of our joint account, Mrs. Fihe and mine, paid for those motors in [51] the amount of \$150.50 and then when the company got some money, they gave me \$150.00.

Mr. Townsend: The records indicate that you paid \$150.50.

Mr. Fihe: Yes.

Mr. Townsend: That is correct. And they indicate that you were reimbursed that amount.

Mr. Fihe: Yes, with the exception that I was fifty cents out on the deal. Will it be so stipulated?

Mr. Townsend: I will stipulate the record so indicates.

There is an entry, September 12, 1947, which is

included on page 3 of Petitioner's Exhibit No. 11 and is listed on the exhibit as sale of furniture, \$5,890.00. The records indicate that that sum was received from the sale of furniture and patent work by Mr. Fihe. It doesn't make any allocation.

Mr. Fihe: May it also be stipulated—just hold it a minute—maybe I had better testify to this, your Honor.

Mr. Townsend: All we are showing is what your records show.

Mr. Fihe: All right, that is so stipulated. Let me make a note of it.

Mr. Townsend: There is an entry of September 30, 1947, showing a \$2,000.00 receipt plus a \$96.40 receipt, which [52] on the books is a deposit. And it is marked Elizabeth M. Fihe account Elizabeth M. Fihe loan. And you are going to testify in respect to that, Mr. Fihe?

Mr. Fihe: Yes.

Mr. Townsend: Again on page 3 of Petitioner's Exhibit No. 11, the three figures at the bottom of that page, specifically \$5,890.00, \$1,000.00 and \$2,600.00 are not included in the total figure shown above, \$24,780.15 as cash receipts.

Mr. Fihe: That is so stipulated.

Mr. Townsend: The books indicate that \$5,890.00 was received, that \$1,000.00 was received, and they do not indicate that \$2,600.00 was paid out by Mr. Fihe, and you were going to testify with respect to that item?

Mr. Fihe: That is correct.

Mr. Townsend: With that, your Honor, the Re-

spondent will stipulate that the records of Mr. Fihe are as indicated on Petitioner's Exhibit No. 11.

The Court: All right, Petitioner's Exhibit No. 11 will be admitted.

(The document heretofore marked Petitioner's Exhibit No. 11 was received in evidence.)

Mr. Fihe: Thank you.

Now, of course, your Honor, it is rather out of order for me to—— [53]

The Court: As long as you are appearing pro se, I don't know how else you can do it. The Clerk will swear you, Mr. Fihe, and you will take the stand.

Mr. Fihe: All right, your Honor.

The Clerk: Will you state your name for the record?

Mr. Fihe: Albert J. Fihe.

Whereupon,

ALBERT J. FIHE

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Court: Now, I don't know if you can do it but make your testimony as factual as possible, so that counsel can cross examine you on it.

The Witness: That I shall attempt to do, your Honor.

If the Court please, I will stand here as I feel more comfortable right here, if that is all right with you.

(Testimony of Albert J. Fihe.)

The Court: It is agreeable to me.

The Witness: First, with regard to the amount of \$5,890.00 which is listed in my Petitioner's Exhibit No. 11 as received by me for the sale of furniture and for patent work, may I ask the Clerk to mark this document which I have for identification as Petitioner's Exhibit No. 12. [54]

(The document above-referred to was marked Petitioner's Exhibit No. 12 for identification.)

Mr. Townsend: I have already seen that.

The Witness: Yes, you have already seen that, Mr. Townsend.

That, your Honor, is a bill of sale for the furniture which I owned at the time and which I had used in connection with my law practice in Chicago and which I had moved to the offices of the partnership, and later the corporation, in order to consolidate my offices.

And when we sold out, I presumably sold that furniture for the sum of \$5,890.00. I got a check for it.

The Court: From whom?

The Witness: From the corporation. Later, there was quite an argument about that and in order to settle the argument and not have any more trouble, I agreed to execute this bill of sale which is here for the furniture and receive only \$8,090.67. That is my signature on the bill of sale. It is dated January 19, 1948.

It is notarized and I hereby offer it in evidence as Petitioner's Exhibit No. 12.

(Testimony of Albert J. Fihe.)

Mr. Townsend: Why is the date changed in there, Mr. Fihe?

Mr. Witness: We had, I guess your Honor doesn't mind if we sort of work this back and forth? [55]

The Court: No.

The Witness: I think it is better if we work this back and forth, rather than definite cross examination. It will be better I am sure.

We had originally agreed to sell our stock in the corporation in the middle of December, 1947, and we had accepted an escrow for it in the amount of \$1,000.00 to bind the agreement, but it appeared, your Honor, that they could not get the remaining \$24,000.00 together within the thirty days agreed upon in the escrow, and therefore, these documents which were prepared about the middle of December, were not executed by me or by Mrs. Fihe.

Later, Mrs. Fihe and I both happened to be in California at that time and they asked if we would give them an extension in order to allow them possibly to get the \$24,000.00 together. We agreed to that and then when they did get the money together, then I executed the bill of sale for the furniture which was in Chicago, and while it was worth a great deal more than that, I agreed to it rather than have any further argument. At the same time, my account was charged with the \$5,000.00 differential.

Mr. Townsend: There is no objection to the document.

(Testimony of Albert J. Fihe.)

The Court: It will be admitted as Petitioner's Exhibit No. 12. [56]

(The document heretofore marked Petitioner's Exhibit No. 12 was received in evidence.)

The Witness: Now, referring to the notes in our joint check stub book dated—the one dated September 30, 1947, and which counsel has asked Mrs. Fihe to read into the record, apparently, if the Court please, that was an inter-family transaction where Mrs. Fihe gave me \$2,000.00 because on that same date I note that I had paid a real estate company in Chicago the sum of \$2,500.00 as a down payment on the cooperative apartment, which we bought at that time and actually to which Mrs. Fihe has testified on cross examination.

And our check book shows that I did not have enough money to cover that check, so apparently she gave me \$2,000.00 for that account to cover the check.

There is another item which Mr. Townsend did not mention, which I think I had better bring out. It is dated May 29, 1947, and it is in my own handwriting in this check stub book, reading as follows: "Elizabeth M. Fihe, 49 shares of Holly Molding Devices, \$4,900.00". Now, I apparently got \$4,900.00 from Mrs. Fihe for 49 shares of Holly Molding Devices stock, which I apparently sold her at that time.

I must have bought it back later because when we turned in our stock, I got paid for it by the corporation and [57] apparently from looking a couple

(Testimony of Albert J. Fihe.)

of pages further on in the book, I find that once again I was quite short of money and had only a couple of hundred dollars in the bank and there was a charge account, my account of \$2,600.00 which I had agreed to give Mr. Harry Holly for legal fees.

In that connection, Mr. Holly was indicted by the Grand Jury in Chicago for attempting bribery of an income tax agent. This happened while I was out here in the west coast and it was while I was working in connection with the corporation. I was out here for six or eight weeks.

When I returned, Mr. Holly told me that our auditor, a man by the name of Bornstein, had arranged with an agent, an internal revenue agent who was at that time going over the books of the corporation, to save us about \$3,000.00 in taxes if Mr. Holly and I would give Mr. Bornstein and the agent \$1,500.00, \$500.00 to be contributed by Mr. Holly and \$1,000.00 to be contributed by me.

Mr. Townsend: Your Honor, I wish to interpose an objection here because I am not familiar with the facts of this case as Mr. Fihe is discussing it. I think it is hearsay as to the actual background of this case and I am not sure of the materiality of it to this case.

The Witness: I am testifying under oath, your Honor, and I am trying to bring out all of the facts so that they will be before the Court. [58]

The Court: Now this \$1,000.00; is that one of the items in controversy here?

The Witness: No, but the \$2,600.00 is.

(Testimony of Albert J. Fihe.)

Mr. Townsend: The \$2,600.00 is.

The Court: The objection is overruled.

The Witness: Thank you, your Honor. And I will now continue. When I returned from the trip, Mr. Holly told me that he had made arrangements with the agent and with our auditor to make the books in such a manner that we would save \$3,000.00 in taxes.

I told Mr. Holly that would not do and I would have no part of it. He said, "I have already made a down payment of some \$200.00 to the agent and you are supposed to give him \$800.00 more, and I am supposed to give the auditor \$500.00".

I told him that that was just out of the question, that I was a reputable attorney at law and I wished no such part of any doings, but he said, "Well, I made the deal and we will go through with it". Now, this is of my own knowledge; I was there. That happened and after considering it overnight, I went to the chief agent in charge in Chicago and reported the whole proceeding and I told him that I felt, rather than just not agree to this thing, I had better report it in the interests of the Government.

Thereupon, the Federal Bureau of Investigation came into the case and they asked me to give the agent some [59] marked money. I objected to that. I said, "I do not want to crucify anybody. The fellow is undoubtedly crooked and I do not want any part of the crookedness, but I don't want to crucify anybody".

(Testimony of Albert J. Fihe.)

The F.B.I. agent insisted that I go along with it because there was a lot of this going on, they said, and that it was never discovered and, "You are only—you will only be doing your duty as a citizen. You have already done your duty in reporting it and now you must help apprehend the culprits", so very reluctantly I went along and I gave the agents marked bills.

And the F.B.I. were outside the building and as soon as he left, I was to pull up a shade, signalling that he had left and of course, they picked him up.

At the trial, it was of course determined that Harry Holly was a partner to it and the auditor and the agent and they got varying terms. Harry got six months and the auditor and the agent got more. That is how this \$2,600.00 comes in, because Harry had a family, a wife and two or three children at that time, and I really hated to see my partner go to the penitentiary, so I offered to pay his legal fee which amounted to \$2,600.00 and that explains that item, your Honor.

The Court: Did you claim that as a business deduction? [60]

The Witness: I never issued a check for it, your Honor, it was merely charged to my account, and of course, I never got the money. It was a company check that was issued, but it was charged to my account and I am filing it as a business deduction, yes.

Now, rather than try to argue the case at this

(Testimony of Albert J. Fihe.)

time, I think I had better do a little bit more testifying.

The Court: That is right.

The Witness: Getting back to 1946, I wish to point out to the Court that it was a true partnership beginning in January of 1945. I personally, as a practising lawyer in Chicago, admitted to the Illinois State Bar, organized that partnership. I am quite sure that I prepared the actual papers and that they were signed by the four of us just as Mrs. Fihe testified.

Regarding the whereabouts of these papers, I have no idea because after Mr. Holly went to the penitentiary, as you can imagine, your Honor, it was—well, there was a terrific amount of ill feeling around the place. I was there. I was the cause of his having been indicted and sentenced and frankly, I wasn't in very good repute.

But I stayed there and continued to run the business. It was, at that time, a corporation. I organized the corporation. The actual date of organization was September 25, 1946, and these documents, some of which are [61] here in evidence, indicate that the original four partners, when the corporation was organized, turned in all their interest in the partnership which was equal four shares for stock in the corporation.

I, as a practising lawyer in Chicago, admitted to the Bar of the State of Illinois, organized that corporation and I am sure it was properly organized. The Certificate of Incorporation was granted

(Testimony of Albert J. Fihe.)

by the Secretary of State and in the Certificate we stated that we were receiving shares in the corporation for our shares in the original previous partnership.

There are some penalties assessed against both Mrs. Fihe and me for negligence in keeping our books. In our protest, we naturally disagree with those penalties. We believe that we kept our books in good shape. In fact, I have here a record of all of our transactions during those years and I believe that Mr. Propeck, the agent here, has gone through that book very carefully.

Well, somebody from this office has indicated negligence but I know that somebody from the Commissioner's office has been through that book. I am positive of that because he came out to my office at Burbank and stayed there for two days. I don't remember whether it was this gentleman or not.

Now, referring to my petition for the year of 1946, [62] there were some deductions which I took and which I am sure were quite correct. And in Chicago, working with the agent's office there, and as I stated at the beginning, I spent one solid week and I was every day in the agent's office and we went through the books, very, very carefully. He checked item by item and he did not miss anything and we agreed that some of my deductions were possibly a little big.

It was also agreed, your Honor, that I forgot to take deductions sometimes to which I was entitled

(Testimony of Albert J. Fihe.)

and we had worked out what I thought was a rather reasonable adjustment of the whole thing.

Then, when the report came in, the agent there with whom I had worked, and who seemed to be quite a nice chap, just backed out on practically all of the things, and of course, he disagreed with our claim that it was a partnership and taxed me for the partnership income, which amounted to a great increase in the taxes. And——

The Court: Well, he just taxed you with the portion that had been paid over to your wife.

The Witness: That is right.

The Court: He did not tax you with the Hollys' part?

The Witness: No, he taxed me with half of the partnership interest instead of a quarter of it. There were other things and I see no point in taking up the Court's time [63] on the little items. For example, in one of these reports, the agent objected to my deduction of \$19.00 for medical expenses. Well, that was the total medical expenses deduction for a whole year and he decided that, no, that was not, and that is just typical of the reaction of this agent to our returns in there.

The same with contributions and interest. I will agree with Mr. Townsend that I accidentally put down interest twice in one of my returns, because there are two places on it and I was working on that return about two hours before midnight on the last night for mailing it, and it was just an

(Testimony of Albert J. Fihe.)

honest mistake. I will agree that there was a mistake.

Now, I believe I did inadvertently deduct some taxes that were not deductible, such as some income tax, but there are a lot of other taxes, such as rent, estate tax and sales tax and so on, which were practically disallowed completely and I know some of these items were properly deductible.

Now, in the year 1947, your Honor, I put down contributions in the amount of \$92.00. Now, I think it is quite reasonable that anybody will make \$92.00 in contributions in a year to churches and other charitable institutions. That was disallowed, the whole in total.

There is another item in 1947 which was charged to me in the way of royalties from Holly Molding Devices in the [64] way—strike that last word—in the amount of \$1,166.57. We never got any royalties from that company. I did get some royalties, but not from Holly. The Holly people reported that in 1947 they had paid Mrs. Fihe and me dividends in the amount of \$8,800.90. Neither one of us ever received any dividends. We did not get money back on loans as evidenced by the notes.

We did draw salary from time to time. In fact, the last year I received a salary of \$400.00 a week regularly and that is shown on Petitioner's Exhibit No. 12. In that exhibit, I stated the net rather than the gross of \$400.00 per week because there was an amount of \$60.00 and some odds taken off for withholding taxes and what not, so I represented the

(Testimony of Albert J. Fihe.)

net amount that I got, but it is obvious in a salary of \$400.00 a week, there is some deduction. That is perfectly understandable.

A great deal of this material from which apparently the agents in Chicago and possibly the agents here have charged to my account and Mrs. Fihe's, was garnered from the records of Holly Molding Devices in Chicago, and by the way, that corporation has changed its name to Hollymatic. H-o-l-l-y-m-a-t-i-c, after we sold out.

They employed some auditors to go through their books and they went back, I think over—well, all the way back to some time in 1945, and they concocted—and I use that term advisedly—some rather peculiar reports and results, [65] showing quite a bit of money either charged to our account or showing money that we were supposed to have received and which we did not get, and which, I am sure, your Honor, is over and above those amounts which we have listed in Petitioner's Exhibit No. 12 and which represents all the money that we ever got out of the partnership or the corporation in those years.

That I am certain of. And they have shown that we got a lot more and I might say, there is some pretty fancy bookkeeping in there. There is a mathematical error of \$64.90, which is minor, of course.

Mrs. Fihe and I invested in some copper company back in 1947 which went broke and we forgot to take off the loss. That should have been deducted and claimed. We accidentally credited ourselves for

(Testimony of Albert J. Fihe.)

only two dependents, when actually we had three. I would have known that we had three children but we only took credit for two, but those are more or less minor items, your Honor, which did not amount to very much at all in the end, it seems to me.

There is an item claimed here of casualty loss of \$2,300.04. In that connection, when we moved our furniture out here, it was certainly in a wreck somewhere, because when we got it, most of it was almost irreparably damaged—a beautiful marble top table that we had was just broken into smithereens—some of the fine furniture looked as if it had been dragged through the mud. The upholstery was torn and [66] almost beyond repair. Some valuable lamps were gone completely. My wife had a very valuable ring somewhere in that furniture and it never did get here. May I say that at one time I saw my wife weeping very bitterly when she saw that furniture.

Again in the 1948 year, contributions—we made contributions, everybody does, but they just disallowed them. Also medical expenses, they were disallowed completely and we are charged with a negligence penalty. I do not understand that at all.

The same in the year 1949, your Honor, we kept books, we kept good records, we turned in our reports as we should and we stated that we had made contributions in the amount of \$238.00—all of it was disallowed.

There was a charge, a deduction of \$10,000.00

(Testimony of Albert J. Fihe.)

some odd dollars, in our return under the heading of "Repairs, advertising, legal expenses, traveling expenses, interest, postage" and some other items—it was just arbitrarily disallowed.

Now, if the Court please, it happened that when we got here in 1948, I practiced patent law and started a little factory in Burbank, trying to do substantially what we had done in Chicago, manufacturing a few little patented items. Well, unfortunately, I picked something which did not sell. It was a fishing reel. And I spent a great deal of money trying to promote the sale of that fishing reel and I spent a [67] great deal of money manufacturing reels, buying dies and tools and parts and so on, all of which was practically a complete loss, but apparently I cannot convince the agents that I managed to lose that much money. I am sorry to say that I did.

Then, so far as the year 1949 is concerned, I was getting money on those notes from the sale of our stock and unfortunately that money was spent also—it also went down the drain in trying to get this factory going in manufacturing and selling these fishing reels.

We just lost money in 1949 and 1950 which, by the way, isn't here before the Court as yet.

The agent reported that my business income was \$10,000.00 some odd dollars in my return which just cannot be. That is in 1949. He disallowed quite a number of charges for repair. When one buys machinery—and I bought second-hand machinery

(Testimony of Albert J. Fihe.)

to start the factory out there—it needs quite a bit of repair. He disallowed \$2,000.00. I spent a terrific amount on advertising in the year 1949, trying to promote the sale of that fishing reel. The agent disallowed \$2,600.00 of it.

I did a lot of traveling; the agent disallowed \$1,900.00 of traveling expenses. He disallowed interest which I had paid on loans in the amount of \$600.00. The agent disallowed postage in the amount of \$249.00. How can a business [68] operate without spending money for postage and that is only \$20.00 a month, which I think is very reasonable.

There is an item here of telecast expenses which he disallowed. It is marked “duplication”. I will have to check that. “Telecast” was the trade name of that fishing reel. Then we were making another called the “Bandmaster” which was also a loss. Although we lost the money, it was disallowed as a duplication.

The item of depreciation was reviewed and some odd \$700.00 was disallowed—depreciation both on real estate and machinery.

Frankly, in summing up, your Honor, I am convinced in my own mind that we paid our taxes. I try to do my duty as an honest citizen. I think the record will show that I have done so, and frankly I have gone about my duty in reporting what happened.

I believe our petition should be allowed practically entirely with the exception of possibly some adjustments relating to mistakes which I admit

(Testimony of Albert J. Fihe.)

were made and which I conclude were made honestly.

Do you wish to ask me some questions now, Mr. Townsend?

Mr. Townsend: Yes, please, Mr. Fihe.

The Witness: I will keep my records and sit up here, if you don't mind. [69]

Cross Examination

Q. (By Mr. Townsend): Mr. Fihe, in 1948, when you sold your stock and your buildings, and your patent rights to the corporation and your residences, did you or do you recall that you made up a schedule D which you did not include in your return?

A. Schedule deed.

Q. D. A. Oh, D.

Q. Yes. A. What is that?

Q. That is a breakdown of the items that you are showing as to capital gain and capital loss. Let me show you your return for that year, Mr. Fihe.

A. Yes, this is our joint return for 1948.

Q. Now, Mr. Fihe, you did not attach a schedule D which is the form which breaks down this item of capital gain. However, you did prepare one and you showed the copy of the one you prepared to the agent in Chicago. Do you recall that, Mr. Fihe?

A. No.

Q. You don't recall showing it to him?

A. No.

Q. That agent purportedly made a copy of that schedule D which you had in your work papers

(Testimony of Albert J. Fihe.)

but did not file. [70] I show you a copy which he purportedly prepared, which is an exact copy of what you showed to him and I ask you if you are familiar with that?

A. I certainly have no recollection of this. It is possible that I made it up in conjunction with the agent.

Q. And all this was prepared at the time of the return you say?

A. But it wasn't attached to the return?

Q. That is correct.

A. I will agree that this photostatic copy that you have here is a photostatic copy of our joint return but I certainly will not admit that I made this schedule up. I do not remember anything about that, but it is possible that the agent may have made it up when he was going over the return at the time.

Q. Do you have your retaining copy of your 1947 return, Mr. Fihe? A. Yes, I may have.

Q. Do you have it here in Court with you?

A. Possibly.

Q. Will you get it for me, please?

A. I will see. That is 1948?

Q. 1948, yes.

A. If the reporter please, that is 1948 to which we are referring. Yes, I have here apparently my work sheet for [71] our joint return of 1948 and also a carbon copy of the typewritten return and if you will bear with me a moment, I will check

(Testimony of Albert J. Fihe.)

it with your photostatic copy and see whether they are in agreement or not.

Yes, I have here in my own handwriting a preliminary draft of schedule D for my return—our return, for 1948, and it checks precisely with the typewritten sheet which you have just handed to me, and——

Q. And that is the sheet that you used to reach your figures for the schedule D page 2 of the return which you filed? A. That is correct.

Mr. Townsend: It is offered in evidence. It is Exhibit A, a copy of the schedule D which was used by Mr. Fihe in preparing his 1948 return.

The Witness: I don't know if I can say that but I have no objection anyhow.

The Court: Admitted.

(The document above referred to was marked Respondent's Exhibit A for identification and was received in evidence.)

Q. (By Mr. Townsend): Now, Mr. Fihe, referring to that same document, Exhibit A, would you please tell the court the various items [72] on the return?

To save time, you reported on there, "Home at Chesterton, Indiana"—is that correct?

A. Right.

Q. And you show a loss on sale in 1948 of \$18,550.60? A. That is correct.

Q. That was your personal residence in Chesterton, Indiana?

A. Our summer home, yes.

(Testimony of Albert J. Fihe.)

Q. I show you up above there, apartment at 179 East Lakeshore Drive, Chicago, in which you apparently sold for the same price that it cost you?

A. We sold it for less than what it cost us but it wasn't worth bothering about so I put down the even money, the even amount.

Q. That was your personal residence?

A. Yes, in Chicago.

Q. There is an item below that "Furniture and fixtures from above". There is a loss reported of \$1,130.48? A. Yes.

Q. That is the furniture and fixtures that were kept at your apartment at 179 Lakeshore Drive?

A. What actually happened was that when we bought the apartment, Mrs. Fihe—and she will bear me out in this—we rebuilt the whole thing. We put in a new kitchen and we [73] carpeted the place and we bought that just about the time of this trouble which occurred with the partnership at Holly's—yes, it was about that time.

Well, after all that difficulty and after we had sold our stock in the company and also in view of the fact that I did have an established practice out here in California practising law and further, in view of the fact that my partner out here had just died suddenly, we decided to move to California, which we did, and we sold our summer home. We sold the apartment, and we took a loss on all the refurnishings and rebuilding that we had put into the apartment.

In fact, I think we took out one wall and made

(Testimony of Albert J. Fihe.)

another room somewhere. It was quite an expense, and I am sure it was more than \$1,100.00 which I showed as a loss but I wanted to be reasonable and consistent about it and we sold it for exactly the same thing as we paid for it, which is \$18,000.00.

Q. Now, when you sold your stock, patent rights and real estate to the corporation in 1948, do you recall who the escrow agent was on that transaction?

A. Can you read that question back, please?

Q. I will repeat it for you. When you sold your stock, and patent rights and real estate to the corporation in 1948, do you recall who the escrow agent was that handled the transaction?

A. Do you mean when Mrs. Fihe and I sold out—when we sold our—— [74]

Q. That is correct.

A. According to Petitioner's Exhibit No. 7?

Q. Well, I don't know what exhibit it is, but when you sold it was Attorney Trust Company and National Bank of Chicago the escrow agent?

A. Oh, that is what you are talking about. Oh, yes, yes, that is correct.

Q. Now, do you recall the patents which were covered under the Holly Molding machines?

A. Yes, I do.

Q. You testified that they were obtained in 1937?

A. The first one was applied for in 1936 and was granted in 1937. Then I obtained several more

(Testimony of Albert J. Fihe.)

patents on improved machines as they were invented by Holly Molding Devices.

Q. Who owned those patents?

A. The first patent was owned jointly by Harry Holly and myself, half interest to each. So far as I can remember the subsequent patents, when granted, were issued to us jointly.

If any were issued in 1945, they would then be assigned to the partnership consisting of Harry H. Holly and Agnes Holly, Elizabeth M. Fihe and myself. If any were issued in the latter part of 1947 or 1946—wait a minute [75] now, I am getting my dates mixed.

Will you read my answer back, please to make sure that I am right?

The Reporter: Yes, sir.

(Answer read.)

The Witness: May I make an insertion in that answer please, your Honor?

The Court: Yes.

The Witness: They were issued to us jointly in the same proportion.

And I will now finish my answer. They were issued to the corporation known as Holly Molding Devices, Inc., to the best of my recollection and there were at least four or five patents.

Q. (By Mr. Townsend): With respect to the patents that you sold to the corporation in 1948, when were they issued?

A. They were certainly issued before the time of the sale and at the time of sale of our stock, there

(Testimony of Albert J. Fihe.)

were some patent applications pending which applications were taken over by another firm of patent lawyers in Chicago. The county also revoked my power of attorneys.

Q. Were these original patents that you sold that were issued to you and Mr. Holly?

A. I sold my interest in them, yes, at the time we sold our stock. [76]

Q. Were those patents used by the partnership?

A. Yes, some of them and some of them did not turn out so well and did not work, so those patents are valueless.

Q. Did you receive anything from the partnership for the use of these patents?

A. That gets back to some of these book transactions which, as I testified, were made after Mrs. Fihe had sold out our interest. These auditors came into the offices of the company and had a very wonderful time.

The Court: Now, Mr. Fihe, that seems to me to be a little argumentative. If you can, stick to Mr. Townsend's questions.

The Witness: Will you read the question back, Miss Reporter, please?

The Reporter: Yes, sir.

(Question read.)

The Witness: Ostensibly according to the books as they now exist, yes. Actually no and may I explain that in just a little more detail, your Honor?

The Court: All right.

Mr. Townsend: Yes, please.

(Testimony of Albert J. Fihe.)

The Witness: After we had sold out, these auditors—I think their names were Barrow, Wade—and something. [77]

Q. (By Mr. Townsend): Certified public accountants? A. What?

Q. Certified public accountants?

A. Maybe they were. Barrow, Wade & Guthrie—that is their name—well, they got into the books in the offices of the company and performed some real unusual feats of bookkeeping wherein Mrs. Fihe and I were charged with sundry sums ranging from \$15.00 to \$5,000.00 or \$6,000.00 and after depositions taken in Chicago showing many of these sums have absolutely no explanation whatever—I remember particularly one item in the amount of \$10,600.00 and some odd dollars which I saw on the books, in the corporation's books when I was attending these depositions in Chicago about one month or so ago.

This was added at the bottom of my account page in pencil and I asked the witness whose handwriting is that. He said, “It is mine”.

I asked him why did he put that amount down at the bottom of my account page in the ledger as charged to me. His answer was “The auditors or the accountants told me to do it”. And that appears in those depositions.

The Court: Well, gentlemen, how much longer do you want to go tonight? It is now 5:00 o'clock.

Mr. Townsend: Well, your Honor, I do have a witness [78] to put on. Would it be possible to

(Testimony of Albert J. Fihe.)

continue this in the morning or later on in the week?

The Court: How long do you want?

Mr. Townsend: I would think possibly another hour, your Honor.

The Court: Well, you are in town?

The Witness: We will suit your Honor's convenience.

The Court: Is 9:00 o'clock too early?

The Witness: Tomorrow?

The Court: Yes.

The Witness: We will be here, your Honor.

The Court: All right, we will recess now and resume tomorrow morning at 9:00 o'clock.

(Witness excused.)

(Whereupon, at 5:05 p.m., Monday, November 28, 1955, the hearing in the above-entitled matter was adjourned until Tuesday, November 29, 1955, at 9:00 o'clock a.m.) [79]

Proceedings

The Clerk: The Court is in session.

Mr. Fihe: Shall I resume the stand, your Honor?

The Court: Please.

Whereupon,

ALBERT J. FIHE

called as a witness for and on behalf of the Petitioners, having been previously duly sworn, resumed the stand and testified further as follows:

Cross Examination—(Continued)

The Court: I hope we will be finished before

(Testimony of Albert J. Fihe.)

10:30 today. I told the other people we were supposed to start at 10:00 but 10:30 will be all right.

The Witness: I am sure we can.

Q. (By Mr. Townsend): Mr. Fihe, are you familiar with Mr. Holly's signature? A. Yes.

Q. And is this Mr. Holly's signature on these notes which are under Exhibits Nos. 3 and 4?

A. 3, 4, 5, 6 and 10, yes, that is Harry H. Holly's signature underneath mine.

Q. Thank you.

A. Signing for Holly Molding Devices, a partnership.

May I interrupt just a moment, please? [82]

Q. Surely.

A. Just as we came into the court, I asked the reporter to check back on my last answer yesterday just before we closed and the answer related to an item of some \$10,600.00 which had been written in in pencil at the bottom of my ledger page on the books of the present corporation identified as Hollymatic Corporation.

I was explaining that in the depositions taken in Chicago on October 10th of this year, I had asked the witness about that entry and he had stated in the deposition that he was told to put that in in pencil by the auditors or accountants.

I do not believe I finished the answer and I wish to now state that I certainly did not receive that \$10,600.00 some odd dollars which was charged to my account and neither did Mrs. Fihe.

There was another point which I asked the re-

(Testimony of Albert J. Fihe.)

porter to check, but she was not able to find the portion before the Court went in session, and that is in relationship to the notes which Mrs. Fihe and I received when we sold our stock.

I am quite sure that I mentioned yesterday that those notes deliberately omitted the words "or order" and were not negotiable for that reason.

The Court: I remember that there was testimony to that effect, Mr. Fihe. [83]

Mr. Townsend: I think that would have been in his opening statement.

The Court: That could have been.

Mr. Townsend: The Respondent moves to strike the reference in the answer as to whether the notes were negotiable or not because it is a conclusion.

The Court: Are the notes in evidence?

The Witness: No, your Honor. They are paid and probably destroyed.

The Court: Well, the motion will be denied.

Q. (By Mr. Townsend): Mr. Fihe, I show you what has been marked as Respondent's Exhibit B for identification and ask you if that is your signature thereon? A. Yes.

(The document above-referred to was marked Respondent's Exhibit B for identification.)

Q. (By Mr. Townsend: I show you what has been marked as Respondent's Exhibit C for identification and ask if that is your signature thereon?

A. Yes.

(The document above-referred to was marked Respondent's Exhibit C for identification.)

(Testimony of Albert J. Fihe.)

Mr. Townsend: May I now have this document [84] marked for identification as Respondent's Exhibit D.

The Clerk: Exhibit D.

(The document above-referred to was marked Respondent's Exhibit D for identification.)

Q. (By Mr. Townsend): I show you Respondent's Exhibit D which has been marked for identification and ask you if that is your signature thereon? A. Yes.

Mr. Townsend: May I now have this document marked for identification as Respondent's Exhibit No. E?

The Clerk: Exhibit E.

(The document above-referred to was marked Respondent's Exhibit E for identification.)

Q. (By Mr. Townsend): I now show you Respondent's Exhibit E which has been marked for identification and ask you if that is your signature thereon? A. Yes.

Q. And Mrs. Fihe's signature?

A. Yes and hers also appears to Exhibit No. C.

Mr. Townsend: May I have this document marked for identification as Respondent's Exhibit F?

The Clerk: Exhibit F.

(The document above-referred to was marked Respondent's Exhibit F for identification.)

Q. (By Mr. Townsend): I now ask you, Mr. Fihe, if that is your signature on Respondent's Exhibit F marked for identification?

A. Is this F?

(Testimony of Albert J. Fihe.)

Q. Yes. A. Are you skipping one?

Q. I think we covered E.

A. Oh, no, this is Mrs. Fihe's signature.

Q. Well, take a look over on the other side.

A. Yes, it is mine on the left-hand side.

Mr. Townsend: May I now have this document marked for identification as Respondent's Exhibit G?

The Clerk: Exhibit G.

(The document above-referred to was marked Respondent's Exhibit G for identification.)

Q. (By Mr. Townsend): I now show you a document which has been marked for identification as Respondent's Exhibit G and ask you if that is your signature thereon? A. Yes.

Mr. Townsend: May I now have this document marked for identification as Respondent's Exhibit H?

The Clerk: Exhibit H.

(The document above-referred to was [86] marked Respondent's Exhibit H for identification.)

Q. (By Mr. Townsend): I show you now a document which has been marked for identification as Respondent's Exhibit H and ask you if that is Mr. Holly's signature thereon?

A. Yes, I recognize it.

Mr. Townsend: At this time, your Honor, Respondent offers in evidence what has been marked for identification as Respondent's Exhibit B, which

(Testimony of Albert J. Fihe.)

is the form 1040 individual income tax return for 1946 of Mr. Albert J. Fihe.

The Witness: No objection.

The Court: It may be received.

(The document heretofore marked Respondent's Exhibit B was received in evidence.)

The Witness: Will I have a copy of this, Mr. Townsend?

Mr. Townsend: Yes, I can give you a copy.

Respondent offers in evidence the document which has been marked Respondent's Exhibit C for identification, which is the form 1040 income tax, individual income tax return which has been admitted for 1946.

The Witness: No objection.

The Court: Admitted.

(The document heretofore marked Respondent's Exhibit C was received in evidence.)

Mr. Townsend: Respondent offers in evidence [87] the document which has been marked Respondent's Exhibit D for identification, which is the form 1040 individual income tax return for Albert J. Fihe and Elizabeth M. Fihe for the year 1947.

The Witness: No objection.

The Court: Admitted.

(The document heretofore marked Respondent's Exhibit D was received in evidence.)

Mr. Townsend: Respondent offers in evidence Exhibit—Respondent's Exhibit E which has been so marked for identification, which is the document

(Testimony of Albert J. Fihe.)

form 1040 individual income tax return of Albert J. Fihe and Elizabeth M. Fihe for 1948.

The Witness: No objection.

The Court: Admitted.

The Clerk: Exhibit E.

(The document heretofore marked Respondent's Exhibit E was received in evidence.)

Mr. Townsend: Respondent now offers in evidence Respondent's Exhibit F which has been been marked for identification, which is the form 1040 individual income tax return of Albert J. Fihe and Elizabeth M. Fihe.

The Witness: No objection.

The Court: Admitted.

The Clerk: Exhibit F. [88]

(The document heretofore marked Respondent's Exhibit F was received in evidence.)

Mr. Townsend: Respondent offers in evidence what has been marked for identification as Respondent's Exhibit G, which is the 1065 form, partnership return of income of the Holly Molding Devices for the year 1946.

The Witness: No objection.

The Court: Admitted.

The Clerk: Exhibit G.

(The document heretofore marked Respondent's Exhibit G was received in evidence.)

The Witness: May I look at that, please?

Mr. Townsend: All right.

The Witness: That is the one I signed.

Mr. Townsend: Respondent offers in evidence

(Testimony of Albert J. Fihe.)

as Respondent's Exhibit H the document marked for identification as Respondent's Exhibit H, which is a form 1065, partnership return of income admitted for 1946 of the Holly Molding Devices partnership.

The Witness: No objection.

The Court: Admitted.

The Clerk: Exhibit H.

(The document heretofore marked Respondent's Exhibit H was received in evidence.)

The Witness: And that is the one signed by Mr. Harry H. Holly. [89]

Mr. Townsend: That is correct.

The Witness: Would you like to look at the last page of that return, your Honor?

The Clerk: H was the last one.

Mr. Townsend: May I have this marked for identification as Respondent's Exhibit I?

(The document above-referred to was marked Respondent's Exhibit I for identification.)

Q. (By Mr. Townsend): I show you what has been marked for identification as Respondent's Exhibit I and ask you if that is Mr. Holly's signature?

A. Yes, I recognize that.

Q. You recognize that as Mr. Holly's signature?

A. Yes, I recognize the signature.

Mr. Townsend: It is offered in evidence as Respondent's Exhibit I, the document marked Respondent's Exhibit I for identification, which is a form 1120, a corporation income tax return for the

(Testimony of Albert J. Fihe.)

fiscal year ending September 30, 1947, of Holly Molding Devices, Inc.

The Witness: I have had no opportunity to study these, your Honor. We do not remember even having seen the original of this particular document before, but with the provision that I will receive a copy of that, so that I can look [90] at it, I have no objection.

The Court: Well, it will be in evidence and you will have a chance to look at it; it will be available to you, Mr. Fihe if you have occasion to seek them.

The Witness: Thank you, and there is no objection to the offer.

The Court: Admitted.

(The document heretofore marked Respondent's Exhibit I was received in evidence.)

Mr. Townsend: May I now have this document marked for identification as Respondent's Exhibit J?

(The document above-referred to was marked Respondent's Exhibit J for identification.)

Q. (By Mr. Townsend): I show you now Respondent's Exhibit J which has been marked for identification, which is a form 1120, corporation income tax return of the Holly Molding Devices for the fiscal year ended September 30, 1948.

A. Subject to the same provisions as before stated, I have no objection.

The Court: Admitted.

The Clerk: Respondent's Exhibit J.

(Testimony of Albert J. Fihe.)

(The document heretofore marked Respondent's Exhibit J was received in evidence.) [91]

Q. (By Mr. Townsend): Mr. Fihe, were your books ever checked by an internal revenue agent prior to the visit by Mr. Propeck in this particular case? A. Yes.

Q. When was that?

A. My books were checked in Chicago periodically, always annually and the same situation prevailed after we moved here to California.

Q. Do you remember a check being made by an agent in Chicago in 1941?

A. I presume the books were checked at that time; that is a long time ago, however.

Q. Did you ever—strike that.

Do you have your protest before you?

A. For 1941?

Q. No, your protest that you filed in this case?

A. Yes.

Q. Would you look at that, please?

A. Excuse me, your Honor, I will see if I can find it. Do you mean the protest for the purpose of this appeal?

Q. That is correct.

A. I have found one here dated 1946. Is that the one to which you have reference?

(No response.) [92]

The Witness: You have shown me a three page document entitled, "Protest against finding of Revenue Agent's Report" dated January 24, 1956. That is signed by me and notarized as of that date.

(Testimony of Albert J. Fihe.)

Q. (By Mr. Townsend): Have you read that, Mr. Fihe? A. Yes, I have.

Q. Particularly this part up here (indicating)?

A. Yes.

Q. Does that refresh your recollection about a check by an agent some time in 1940?

A. Yes, Mr. Propeck.

Q. This is in 1940, Mr. Fihe, in Chicago.

A. This document, in the second paragraph mentions Examining Officer John J. Propeck.

Q. What date?

A. Well, he made a report dated January 3, 1951.

Q. The part I am specifically referring to Mr. Fihe is on page 3—would you read that part right there (indicating)? A. All right.

Q. Will you read it into the record?

A. "I hereby state under oath that my books have been and always will be carefully kept especially since an original difficulty with one of your agents in 1940. This previous agent suggested that I maintained more accurate books [93] both in connection with my original practice of patent law and my business with which I might be associated collaterally."

Q. Thank you.

A. And may I add, your Honor, that I have here in California, my records of my business and I think those records start in 1940 and continue down to date. I did not offer that book because it

(Testimony of Albert J. Fihe.)

is too voluminous and it is something which I use almost daily.

Q. That statement contained in your protest is correct, about the agent advising you?

A. Yes, I was so advised. I believe I have fully complied with his suggestion.

Q. Now, these records that you have been speaking of, the records that you have here in Court, show receipts as determined from bank deposits; is that correct, Mr. Fihe?

A. You are referring to our check stubs?

Q. I am referring to any of your records.

A. Yes, those records show moneys received over the years, both in the check stubs and the book which Mr. Propeck is now examining and which is a rather large, heavy book, having solid black back and cover with approximately three hundred or four hundred loose leaf pages in it. The pages are about 10" by 16".

Q. Well, Mr. Fihe, my question was, your receipts in your books and records—your checks and records, reflect [94] bank deposits; is that correct?

A. Yes, of course.

Q. So that if you received money that was not reflected in the bank, it isn't reflected in the records?

A. Any money that Mrs. Fihe and I received was deposited in the bank account.

Q. Are you sure of this?

A. I am positive.

Q. Everything you received?

(Testimony of Albert J. Fihe.)

A. Everything.

Q. Now, if you did not receive the cash itself, then there would be no entry in your receipts; is that correct, Mr. Fihe?

A. That is exactly the point I am trying to make. There are a lot of charges in the books of this Hollymatic Corporation against us, which we certainly did not receive, your Honor.

Q. Well, would you answer my question, Mr. Fihe?

If an item was not received in cash, it isn't reflected in receipts in your records; is that correct?

A. Will you read that question back, please?

The Reporter: Yes, sir.

(Question read.)

The Witness: There is a double negative there. I don't know what you are getting at but I can certainly answer [95] the question by saying that all money that was received was put into our bank account.

The Court: Have you reference to notes, Mr. Townsend?

Mr. Townsend: No, your Honor. For example, just a hypothetical case, if a debt was paid by someone else, his records would not reflect any receipt because of that debt being liquidated.

The Witness: I think there is one entry where the partnership, I think it paid an income tax for me in the amount of about \$600.00.

Q. (By Mr. Townsend): We were discussing that yesterday.

(Testimony of Albert J. Fihe.)

A. Yes, and that was charged to my account but I made a record of that in my check stub book and it is there and you saw it.

Q. That is correct. Now, other than that, Mr. Fihe, your records reflect cash received?

A. There was some cash, yes.

Q. On the tangibles, if you received notes, if you received property or cash, your records would reflect that; is that correct?

A. So far as I can remember we received no cash whatever from Holly Molding Devices. I did receive some cash payments from clients in connection with my patent practice [96] from time to time but they were very few and negligible. Practically all business these days, as you know, is done by check.

Q. But you are sure that everything you received went into your bank deposits?

A. Absolutely.

Q. Now, Mr. Fihe, I show you a letter dated March 7, 1952, to the United States Treasury Department and I ask you if you sent that letter?

A. Yes, my signature is on it.

Q. Would you please read, Mr. Fihe, the paragraph beginning on page 2 of that letter; would you read that into the record, please, Mr. Fihe?

A. Yes. "With regard to the purchase and sale of North West Airlines stock, I attach hereto a notice of purchase of the stock through Chapman—through Fardwell Chapman Co., of Chicago".

"The cost being \$2,501.60. There is also attached

(Testimony of Albert J. Fihe.)

a letter from the Bankers Trust Company of New York to the effect that the stock was sold on May 26, 1928; on that day the price of the stock was \$25½ bid, \$26 asked.

“Assuming that we sold it—and may I parenthetically state that it was a joint ownership of Mrs. Fihe and myself—assuming that she sold it at \$26 our profit would be approximately \$100.00 and I assume will be classified as a long term gain. [97]

“Very frankly, I can find no record of having received this money, and I am still trying to determine what happened to it. It is certainly not recorded as a deposit in any of our checking accounts, and no one seems to be able to tell me what happened to the check or by whom it was endorsed.”

Now, may I explain that to this Court? I have since discovered what happened to that one.

Mr. Townsend: In the interests of time, your Honor, I have no objection. If the Court feels it will save time, perhaps the redirect could go on from here?

The Court: I am sure it will.

Redirect Examination

The Witness: That stock was sold and I gave the check to the South East Bank in Chicago, to which bank we owed some money—I don't know how much it was—I have since discovered that that is what happened to that money.

At the time of writing that letter, I did not know what had happened to it.

(Testimony of Albert J. Fihe.)

Recross Examination

Q. (By Mr. Townsend): You were testifying yesterday with respect to the \$2,600.00 item, the legal fees, for Mr. Holly? A. Yes. [98]

Q. There is no check indicating any payment by you of that, is there?

A. No, that was charged to my account.

Q. When you say, "charged to your account", do you mean charged to your personal account or the corporation records; is that correct?

A. Yes, I am sure it is.

Q. That means that the corporation advanced the \$2,600.00 for you? A. Apparently right.

Q. And you deducted that \$2,600.00?

A. I deducted it in my account book here as an expenditure.

Q. Mr. Fihe, do your records reflect receipt of that \$2,600.00 item? A. Receipt of it?

Q. Yes.

A. The \$2,600.00 was paid out of the company funds to the attorney representing Mr. Holly at the time that he was indicted for this income tax evasion matter and it was charged to my account. I certainly haven't got the money. In fact, I spent the money. It is gone.

Q. Is it shown in your personal records?

A. Yes.

Q. Will you show me how it is shown in your [99] records—how it is reflected as a receipt?

A. It isn't reflected as a receipt. It is reflected

(Testimony of Albert J. Fihe.)

as an expenditure and I deducted it as an expenditure in my return for that year.

Q. Directing your attention to Exhibit 7, Mr. Fihe, which is a deed from the partners or a deed from Albert J. Fihe, Elizabeth M. Fihe, Harry H. Holly and Agnes Holly, to Edwin F. Zukowski—how did you happen to have the original of that deed?

A. There were two documents executed. This particular document was never notarized and it just happened to remain in my files. The original, of course, was delivered—the original notarized document.

Q. You made up two originals?

A. Yes, we may have signed three or four.

Q. Originals? A. It is possible.

Q. Now, are there buildings on that property?

A. Yes, there is a building on it.

Q. What is that land and building?

A. It is a twenty-five foot lot, and probably about one hundred feet deep. There was a frame building on it which we built ourselves and it adjoined the brick building which we also owned and in which we originally started the business. [100]

Q. So that this property was apart from the building and property in which the business was carried on?

A. It was connected and it adjoined it.

Q. Was that sold to Mr. Zukowski?

A. It was a mesne assignment whereby we transferred to Mr. Zukowski, who was one of our law-

(Testimony of Albert J. Fihe.)

yers there, and he transferred it to the corporation.

Q. What was the actual corporation—I mean what was the actual consideration received on that?

A. \$1.00, I think all the way around. It says \$10.00.

Q. What happened to the rest of the property?

A. It was all sold to the corporation at the time the partnership was dissolved and the corporation was organized.

Q. Which was at the same time as these?

A. Let me see the date—yes, that is correct.

Q. Well, how was the other property handled?

A. The stock was distributed.

Q. No, you mentioned the building.

A. Oh, the other real estate?

Q. Yes.

A. There were probably some deeds transferring the other real estate from the partnership, the four parties, to the corporation which I had just organized, but it just happens that I did not have any copies of those.

Q. Was that accomplished in the same fashion?

A. I don't think so. I think that was a direct transfer from the partnership to the corporation.

Q. Now, when did the partners acquire that property, Mr. Fihe?

A. We bought it probably in 1945.

Q. That was distributed to the partners by the partnership; is that correct, before the corporation was formed?

A. Yes, the four partners owned that real estate.

(Testimony of Albert J. Fihe.)

Q. Now, directing your attention to Respondent's Exhibit H and to Schedule D thereof, you will note the term, "Building cost \$11,991.32" with an asterisk at the bottom, distributed to the partners, September 30, 1936; is that the property that we are discussing?

A. That certainly must be, yes.

Q. And that is the property that was sold to the corporation when your stock and patent rights, et cetera, were sold?

A. That is right, I am sure. I believe, however, that for a little time the partners kept the real estate and we rented it to the corporation for some nominal sum, \$100.00 a month, or something like that.

Q. I see. Now, yesterday you also testified about the use of the patents that you and Mr. Holly owned, their use by the partnership; how about their use by the corporation; they were used by the [102] corporation, were they not, during the year 1947?

A. Yes, there was an attempt made at one time to work out a series of royalty payments whereby Mr. Holly and I, as joint owners of the partnership, would collect royalties from the corporation for the use of those patents, and we went so far as to draw up a royalty agreement. However, I doubt whether that royalty agreement was ever signed by either the corporation or ourselves.

Q. Wasn't there more than one such agreement?

A. Yes, we drew up two or three and nobody

(Testimony of Albert J. Fihe.)

seemed to like any of them and I doubt whether any of them were ever actually signed, as I say.

Q. Yesterday we also spoke about the sale of forty-nine shares or the purchase of forty-nine shares. I believe you could not ascertain just exactly what the proposition was. I believe you testified that it may be that you purchased those shares from Mrs. Fihe; do you recall that?

A. No, she sold them to me—no, I sold them to her. It was an inter-family transaction. I needed some money at the time. We were buying that cooperative apartment and I sold her my stock in Holly Molding Devices for \$4,900.00 and she gave me a check for it.

Later, she either bought it back or I gave it back to her because she had it when we sold out.

Q. I show you Respondent's Exhibit D, which is your individual income tax return for 1947, and direct your attention to the schedule D thereon, particularly long term capital gains. A. Yes.

Q. What does that read, Mr. Fihe?

A. It says, "Sold" and what it cost me. It says, "Referring to Holly Molding Devices, forty-nine shares". That helps to explain that particular inter-family transaction.

Q. You did not report any gain or loss on that?

A. No, there wasn't any.

Q. Now, when you received these notes from the corporation for the sale of your interest in 1948, you also received a chattel mortgage securing these notes, did you not? A. Yes, we did.

(Testimony of Albert J. Fihe.)

Q. And that covered all machinery and equipment of the corporation?

A. Yes, but it certainly wasn't anything like the \$70,000.00 face value of the notes. They did not have that much machinery in the place.

Q. When did you commence your law practice in Los Angeles?

A. I have had an office in Los Angeles for thirty years.

Q. For thirty years? A. Yes. [104]

Q. And how about Chicago?

A. I had an office in Chicago for thirty-four years—well, it isn't there any more now—but I started out in 1921.

Q. Now, to get back to that building and land or the two buildings and land, real estate, that you owned as partners and sold to the corporation. Was that property encumbered by a mortgage at any time?

A. There may have been a mortgage on it when the partnership bought it, but we bought it, I think, for cash. We may have borrowed some money from the bank to help us buy it and we probably owed the bank some money, but I don't think there was a mortgage on the property when we owned it.

Q. Well, you still owed the bank some money on it at the end of the partnership in September, 1947?

A. Yes, we always owed the bank money.

Q. How about your patents which you sold to the corporation and your stock; were they encum-

(Testimony of Albert J. Fihe.)

bered in any way by means of a chattel mortgage or otherwise? A. No.

Q. You did not borrow any money on it?

A. No, we did not borrow any money on the corporation stock.

Q. I mean your personal holdings.

A. No, we could not. I tried to, but the bank [105] would not let us have anything.

Q. When you sold that property to the corporation in 1948, that is the real estate buildings and land, was there still a mortgage on it?

A. On the property sold in 1946?

Q. Was it sold to the corporation in 1946?

A. Yes.

Q. Your deed is dated 1948 there.

A. 1946, Petitioner's Exhibit No. 7.

Q. Well, when was the remainder of the property sold—do you remember you had an adjoining building?

A. An adjoining lot to this property?

Q. Yes, an adjoining lot to this property mentioned in your deed, Exhibit No. 7, was that the property that you sold in 1948 to the corporation?

A. No, this was the lot on which we had the frame additional and we bought that as of 1946. Now, the partnership kept the brick building for a time after the corporation was organized. I think the partnership retained the title and the partners did collect some rent for that for some time. That rent was paid to us by the corporation.

(Testimony of Albert J. Fihe.)

Q. And that was the property that you sold in 1948 to the corporation?

A. That was sold when we sold out everything. That was part of the \$100,000.00 transaction. [106]

Q. Was that specific property encumbered by a mortgage when you sold it to the corporation?

A. Not that I know of.

Q. Now, when you moved out here from Chicago in 1948, I believe you moved your family to a hotel; is that correct, Mr. Fihe?

A. Yes.

Q. What hotel was that?

A. The Miramar.

Q. Now, you deducted the hotel bill as a travel expense in your return, did you not?

A. Yes.

Q. Now, on what basis do you think you could deduct the cost of new suits as advertising expenses?

A. If I do not look pretty prosperous, I do not get the patent business.

Q. But you did deduct them as advertising expenses?

A. Yes, I think it is perfectly good advertising and the only way a lawyer can advertise.

Q. How about the deduction of your automobile expenses, Mr. Fihe?

A. I use a car in my business daily. In addition to going to and from work and this condition prevailed in Chicago and also here. My clients are scattered over a wide territory. Very few clients come to see me. They usually [107] have a large

(Testimony of Albert J. Fihe.)

machine or some equipment on which they want a patent and I have to go and see that.

They also usually have a number of engineers, officers of the corporation, or the owners of the business, who want to all be present when the device is examined by me. Therefore, I do a great deal of traveling around locally and also nationally, in connection with my patent work.

Q. Now, Mr. Fihe, I show you Respondent's Exhibit No. 7, which is your individual income tax return for 1949 and you were testifying respecting the deductions on that return yesterday.

A. Yes.

Q. Will you turn to page 3 of that return, please? A. Yes.

Q. There is a deduction there for interest in the amount of \$3,909.95.

A. Yes, I explained that yesterday.

Q. Just a minute; you have an item on there for interest in the amount of \$3,909.95?

A. Yes.

Q. Now, turning to page 2 thereof, under schedule C, profit or loss from business, on line 13 interest on business indebtedness; what is the figure there? A. The same amount, \$3,909.95.

Q. Is that the same deduction? [108]

A. I deducted that twice.

Q. Now, turning back to page 3, another item, taxes, what is the amount there, please?

A. \$3,511.44.

Q. Turning back to page 2 schedule C line 14,

(Testimony of Albert J. Fihe.)

taxes on business or business property, what is the amount there, please? A. The same amount.

Q. Is that deducted twice? A. Yes.

Q. Now, on the sale of your property to the corporation in 1948, you previously received in December, 1947, a payment of \$1,000.00 from the corporation on the option, did you not?

A. That was an escrow or option check.

Q. You received that \$1,000.00? A. Yes.

Q. And the next month you received \$24,000.00 as a check? A. That is correct.

Q. Were you in charge of the partnership books of the Holly Molding Devices partnership?

A. Yes.

Q. Were you also in charge of making up the returns, Mr. Fihe? A. Yes. [109]

Q. Were you in charge of the corporation books in 1947? A. Yes.

Q. Were you still in the business in June of the year 1947?

A. Yes, I was president of the corporation.

Q. And you were in the office regularly about that time? A. Every day.

Q. Are you familiar with the certified public accounting firm of Barrow, Wade & Guthrie, at that time? A. Yes, I employed them.

Q. They came to the business and worked there at your specific request, is that right? A. Yes.

Q. And they were there when you were there?

A. Oh, yes.

(Testimony of Albert J. Fihe.)

Q. Now, how did you acquire your half interest in the patents of that venture of Mr. Holly's?

A. That was the original agreement which he and I made back in 1936.

Q. Did you perform the service in getting the patent for him? A. Yes. [110]

Q. In getting his inventions patented?

A. Yes.

Q. And for those services you received a half interest in the patents? A. That is correct.

Q. Now, in relation to acquiring that patent, when was the partnership formed?

A. The original partnership consisted of Mr. Holly and me and we owned equal shares.

Q. I mean, did you form the partnership immediately upon receiving the patent title or before that?

A. We formed the partnership immediately on applying for the patent in 1946.

Q. Did you have authority to draw checks on the partnership?

A. The checks were all countersigned.

Q. Countersigned by whom?

A. In the beginning Harry Holly and I both. When the four party partnership was organized, our understanding and agreement was, and our instructions to the bank was that there had to be one of the Hollys sign and one of the Fihe's sign every check, and that they would not receive or pay a check signed by say either both Hollys or by both Fihe's.

(Testimony of Albert J. Fihe.)

Q. Did you draw checks in conformance with those by-laws? [111] A. Oh, of course.

Q. How about the corporation; did you have authority to draw checks on the corporation?

A. Not by myself, they had always to be countersigned by one of the Hollys.

Q. Did you draw checks so countersigned?

A. Oh, yes, and when Mrs. Fihe drew a check, it was countersigned by one of the Hollys.

Q. Now, yesterday we were talking about furniture that you sold to the corporation? A. Yes.

Q. In December, 1948. A. Yes.

Q. Do you recall that? A. Yes.

Q. What type of furniture was that?

A. There is a list here and I think the bill of sale is in evidence.

Q. Well, was that personal furniture or——

A. It was my office furniture which I had brought out to the offices of the corporation from my down town loop office in Chicago.

There are two items which could not properly be classified as "office furniture". Namely, one ping-pong table and one Kelvinator refrigerator, but that material had [112] been brought out—those two items had been brought out from my home to the offices of the company and they were being used out there.

Q. Directing your attention to Respondent's Exhibit D, your income tax return for the year 1947, and specifically to schedule F, the deduction for

(Testimony of Albert J. Fihe.)

depreciation for 1947, there is an item office furniture in which you deducted depreciation of \$64.9.

A. Yes.

Q. Is that the same furniture?

A. It probably is, I think, with the exception of the refrigerator and the ping-pong table.

Mr. Townsend: That is all, your Honor.

The Court: Thank you, Mr. Fihe.

Mr. Fihe: Thank you, sir.

(Witness excused.)

Mr. Fihe: If the Court please, that closes the Petitioners' case.

The Court: Thank you, sir.

Mr. Townsend: Do you rest, Mr. Fihe?

Mr. Fihe: I rest.

Mr. Townsend: At this time, your Honor, the Respondent offers in evidence, the direct testimony, the redirect testimony and the objections to the cross examination in the deposition of Mr. Frank H. Wiscons, taken pursuant to [113] the order of this Court on October 10, 1955, in Chicago, Illinois.

Mr. Fihe: No objection.

The Court: It will be admitted.

Mr. Townsend: And I believe the Court has a copy of this deposition.

The Court: There is a copy in the docket.

Mr. Townsend: Mr. Propeck, will you take the stand?

The Clerk: Will you tell us your name, Mr. Witness?

Mr. Propeck: John J. Propeck.

Whereupon,

JOHN J. PROPECK

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Townsend): Will you state your name, please? A. John J. Propeck.

Q. By whom are you employed?

A. Internal Revenue Service.

Q. How long have you been so employed?

A. Ten years on the 28th of March of next year.

Q. What is your position with the Internal Revenue? [114]

A. GS11, Internal Revenue agent.

Q. Internal Revenue agent? A. Yes.

Q. And you have been an Internal Revenue agent for ten years? A. Yes, sir.

Q. What is your actual background in accounting, Mr. Propeck?

A. I was graduated from the University of Notre Dame in 1941, when I majored in accounting and since that time I have completed some post-graduate courses at the University of California, Los Angeles, and have the certificate of certified public accountant in the State of California.

Q. Does your work as an Internal Revenue agent constantly expose you to accounting work?

A. Yes, sir.

Q. Now, at my request, Mr. Propeck, did you prepare certain documents on the basis of deposi-

(Testimony of John J. Propeck.)

tions which were taken on October 10, 1955, in Chicago? A. I did.

Mr. Townsend: May I have this marked for identification as Respondent's Exhibit K?

The Clerk: Exhibit K for identification.

(The document above-referred to was marked Respondent's Exhibit K for identification.)

Mr. Townsend: May I also have this document marked for identification as Respondent's Exhibit L?

The Clerk: Exhibit L.

(The document above-referred to was marked Respondent's Exhibit L for identification.)

Mr. Fihe: Which one is L?

Mr. Townsend: This one (indicating).

Mr. Fihe: Oh, thank you.

Q. (By Mr. Townsend): I show you what has been marked for identification as Respondent's Exhibit K, and ask you to state what that is.

A. Exhibit K is a schedule of reconstruction of personal account from Hollymatic books of account based on the deposition taken in Chicago on October 10, 1955.

Mr. Townsend: Respondent offers in evidence as Respondent's Exhibit K, the document which has just been identified by the witness.

Mr. Fihe: If the Court please, I have not had an opportunity to check this thing in detail. It is quite voluminous, but I have no objection to the document provided I can reserve the privilege to

(Testimony of John J. Propeck.)

comment upon any discrepancies or whatever else I may find therein.

The Court: The document, after it is introduced into evidence, Mr. Fihe, you will have the privilege of [116] withdrawing any of these exhibits for use in briefing or for comparity purposes and you can then argue from them.

Mr. Fihe: Mr. Townsend has kindly furnished me with a copy.

Mr. Townsend: I may point out, your Honor, that the primary reason for preparing this exhibit is to put into book form the deposition.

The Court: All right, admitted.

The Clerk: Exhibit K.

(The document heretofore marked Respondent's Exhibit K, was received in evidence.)

Q. (By Mr. Townsend): I now show you what has been marked as Respondent's Exhibit L for identification and I will ask you to state what that is.

A. Exhibit L is also a schedule of reconstruction of personal account from Hollymatic books of account based upon the deposition taken on October 10, 1955, in Chicago, Illinois.

Mr. Townsend: Respondent offers in evidence Respondent's Exhibit L which has been marked for identification by the Clerk, and which exhibit has been identified by the witness.

Mr. Fihe: Subject to the same objection—I mean reservation, there is no objection.

The Court: Admitted. [117]

(Testimony of John J. Propeck.)

The Clerk: Exhibit L.

(The document heretofore marked Respondent's Exhibit L was received in evidence.)

Mr. Townsend: May I now have this document marked for identification as Respondent's Exhibit M?

The Clerk: Exhibit M.

(The document above-referred to was marked Respondent's Exhibit M for identification.)

Mr. Fihe: What is it?

Mr. Townsend: Exhibit M—I will have the witness describe it.

Q. (By Mr. Townsend): I now show you what has been marked for identification as Respondent's Exhibit M and ask you to tell us what it is?

A. Exhibit M consists of a transcript from the deposition taken on October 10, 1955, at Chicago, Illinois, and actually represents two journal entries reflecting the salary paid to Mr. Fihe, and also a journal entry to accrue the salary due Mr. Fihe at April 30, 1947.

Mr. Townsend: I now offer Respondent's Exhibit M marked for identification in evidence.

Mr. Fihe: Subject to the same reservations, no objection.

The Court: Admitted. [118]

(The document heretofore marked Respondent's Exhibit M was received in evidence.)

Q. (By Mr. Townsend): Now, Mr. Propeck, directing your attention to Respondent's Exhibit M and to Respondent's Exhibit K, would you please

(Testimony of John J. Propeck.)

key Respondent's Exhibit M into Respondent's Exhibit K, and I believe that only applies to the second entry on that sheet?

A. That is right. In regard to Respondent's Exhibit M the \$10,706.20 credit to Albert J. Fihe's personal account arose from a journal entry which accrued from salaries in a total amount of \$23,840.00, \$10,706.20 of which was credited to Mr. Fihe's personal account as shown on the right hand side of Respondent's Exhibit K and enumerated or entered at April 30, 1947, as a journal entry.

The notes as taken from the deposition, indicate that there was accrued salary for the seven months for the period of April 30, 1947, which wasn't paid at the time it was accrued on Hollymatic Corporation's books.

Q. Now, Mr. Propeck, you have heard Mr. Fihe testify yesterday with respect to his disallowed deductions to the effect that the deductions were entirely disallowed. Take, for example, the year 1948, and very briefly run through some of the disallowances of expenses, showing what was paid and what was disallowed. [119]

A. In the year 1948, the taxpayer claimed interest in the amount of \$3,111.84. \$2,876.44 of that amount was allowed and \$235.40 was disallowed.

In the same year, travel expenses were claimed in the amount of \$8,679.14. They were allowed in the amount of \$2,876.17 and an aggregate of \$5,892.97 were disallowed.

The Court: Those items you are testifying to,

(Testimony of John J. Propeck.)

Mr. Propeck, aren't they set out in the deficiency notice?

The Witness: Yes, sir.

Mr. Townsend: The notice of deficiency doesn't show what was claimed and what was allowed or disallowed. You have to have the key from the ninety day letter.

The Court: All right.

Mr. Townsend: Maybe we can shorten that.

Q. (By Mr. Townsend): Mr. Propeck, is that true with respect to almost all of the items claimed for, that there were substantial amounts which were allowed?

A. Yes, sir. Out of thirteen items that had adjustments made to them, only one was disallowed in toto.

Mr. Fihe: May we object to the question and answer, your Honor, particularly to the word "substantial" in the question?

The witness has just testified that in the item of travel expenses where I claimed an expenditure of some [120] \$6,000.00, they disallowed \$5,800.00 of it.

The Court: The use of the word "substantial" means something different to everyone. It is an adjective.

Q. (By Mr. Townsend): Mr. Propeck, did you work on this particular case that we have here before the Court today?

A. Yes, sir, I did.

Q. In what connection?

A. I commenced an audit back in 1950 for the

(Testimony of John J. Propeck.)

years 1947, 1948 and 1949 for both Alfred J. Fihe and Elizabeth M. Fihe.

Q. You heard Mr. Fihe testify yesterday with respect to a casualty loss which he claimed in 1948 of \$2,300.04; what did you find that amount represented?

A. I found that on examination of the check book stubs that Mr. Fihe presented at the time, that the \$2,300.04 consisted of two items, namely, \$2,086.04 which was claimed as a casualty loss and represented the personal loss of furniture he had shipped from Chicago to Los Angeles, which had been damaged en route.

And he measured this cost of purchasing—the purchase of furniture in Los Angeles, and the record shows it represented the cost of purchasing new furniture.

The remaining \$214.00 represented, according to the taxpayer's records, cash from a stolen wallet.

Q. Now, Mr. Propeck, in determining the basis, the taxpayer's basis in the stock, patent rights and properties which he sold to the corporation, the Commissioner determined roughly \$20,000.00 was the basis.

Could you please explain how that figure was arrived at?

A. May I have that question read, please?

The Reporter: Yes, sir.

(Question read.)

The Witness: On Respondent's Exhibit H, page 4, there was a balance sheet for Holly Molding De-

(Testimony of John J. Propeck.)

vices for its short period ending September 30, 1946, and in schedule I, on page 4 of that return, are the—I beg your pardon—schedule H of that return, are the capital accounts of Harry H. Holly, Agnes Holly, Albert J. Fihe and Elizabeth M. Fihe, in the amount of \$8,174.57 each.

The \$16,349.14 represented the investment to Alfred J. Fihe and Elizabeth M. Fihe at September 30, 1946 immediately before these capital accounts were transferred to the books of the corporation.

Based upon the accounting transaction involved, it would appear that Mr. and Mrs. Fihe received stock in the amount of the capital account balances that they had at the time the partnership was dissolved.

Q. How about the land and buildings; the basis for [122] that, Mr. Propeck?

A. In Respondent's Exhibit H, counsel doesn't show the land and buildings. I believe that is on a previous sheet—oh, I beg your pardon—in schedule D of page 2 of the return, there were \$11,991.32 in buildings which were distributed to the partners at this same date, 9-30-46. They were apparently held individually at that date—after that date.

Q. Now, Mr. Propeck, to go back to your schedule H on Exhibit H, we find a total amount of capital accounts showing \$32,698.28; is that correct?

A. Yes.

Q. How was that handled so far as the corporation was concerned?

A. At the time the corporation was organized,

(Testimony of John J. Propeck.)

I believe that it was in—the deposition shows that there was \$20,000.00 in capital stock authorizations which had been subscribed to by the Fihe and the Hollys and that the remaining \$12,698.28 out of the total of \$32,698.28 was treated as a credit on the corporation books.

Q. So that your determination basis then was the land as shown in the return reduced by depreciation, which had been taken, plus the sum of the capital accounts?

A. Land and buildings you mean?

Q. Yes, is that correct? [123]

A. Yes, that is correct. However, it would appear to me that the \$11,000.00 for the buildings and the land cost were excluded from the corporation at the time of incorporation and all your remaining \$32,698.28 was transferred to the corporation books.

Q. At that time——

A. The Fihe and the Hollys held the land and buildings themselves.

Q. That is correct but they sold that land in 1948.

A. Back to the corporation.

Q. That is right. Now, were all the liabilities owed to Mr. and Mrs. Fihe by the partnership assumed by the corporation?

A. Yes, sir.

The Court: That is according to the corporation's books?

The Witness: Yes, and I think that Mr. Fihe testified to that yesterday.

Q. (By Mr. Townsend): Now, Mr. Propeck,

(Testimony of John J. Propeck.)

you recommended the assertion of the negligence penalty in this case; what was your basis?

A. Well, I would say the primary reason for having recommended the negligence penalty originally was the fact that the taxpayer had deducted withholding taxes which the Government had withheld at source on page 3 of his income tax [124] return.

Secondly, we found upon audit that there were duplication of items. Where there were two portions for the items to go on the return, the taxpayer had claimed them in two instances on two separate spots on the return.

Thirdly, at the time the audit took place, Mr. Fihe did not have any records available, other than those check book stubs that were referred to yesterday in the testimony.

Q. You have examined those check stubs?

A. I did examine those check book stubs in 1950 and subsequently this case, at Mr. Fihe's request, was transferred to the Chicago Division and I would like to point out to the Court that Mr. Fihe mentioned in his testimony yesterday that he spent a solid week with the Internal Revenue agent involved and the ninety day letter for the case was prepared in this office, based solely upon the recommendations of the Chicago Division, indicating that the Chicago Division still thought that the negligence penalty should be asserted.

Q. Did the Chicago Division have a detailed audit of Mr. Fihe's records? A. Yes, sir.

(Testimony of John J. Propeck.)

Q. They prepared a report in the Chicago Division, did they?

A. Yes, and transferred it to Los Angeles.

Mr. Townsend: No further questions, your Honor.

Mr. Fihe: Just about three questions on cross [125] examination, if the Court please.

Cross Examination

Q. (By Mr. Fihe): You have just testified, Mr. Propeck, that the information regarding which you have before you was mainly received from the Chicago office, is that right?

A. It is stated that the ninety day letter was based on an audit performed in the Chicago office.

Q. And then may we assume that the records of Hollymatic Corporation, the successor to the corporation to whom Mrs. Fihe and I sold out, were the basis of that Chicago report?

A. I cannot recall from memory, Mr. Fihe when the name was legally changed from Holly Molding Devices to Hollymatic Corporation without reverting here to the deposition taken.

Q. Well, that isn't necessary.

A. I would state though that the ninety day letter that was prepared was based solely on a report apparently devised from the books of Holly Molding Devices instead of the Hollymatic Corporation.

Q. Will you refer to Exhibits K and L just before you right now? A. Yes.

Q. Isn't it a fact that that—strike that. Isn't it

(Testimony of John J. Propeck.)

[126] a fact that they stated that those are taken from the records of the Hollymatic Corporation?

A. Yes, sir, they do.

Q. Do you know or do you not know whether these were reconstructed records made after Mrs. Fihe and I had sold our interest?

A. I don't know of my own knowledge, but from reading the deposition.

Q. What is the second line of both Exhibits K and L, Mr. Propeck?

A. I am sorry, mine are not marked. Is the K for you and the L for your wife?

Q. That is correct.

A. And you want the debit or the credit side?

Q. No, just read the title under our names.

A. "Schedule of reconstruction of personal accounts from Hollymatic books of account, based upon deposition taken on October 10, 1955, at Chicago, Illinois."

Q. Now, do you know or do you not know that after we had sold out our interests, Holly Molding Devices or Hollymatic employed these auditors or accountants to go back over the books of the corporation for the years 1946, 1947 and possibly 1945 and work up this schedule referring to Exhibits K and L?

A. Do I know that of my own knowledge? [127]

Q. Yes, do you?

A. I don't know that of my own knowledge.

Q. You have testified that when the corporation

(Testimony of John J. Propeck.)

was organized, there were some actual transferable assets of \$20,000.00 represented by two hundred shares of common stock, \$100.00 par value, and that there was an excess or surplus of about \$2,000.00; doesn't that pretty nearly represent the figure of \$35,000.00 that Mrs. Fihe and I have testified we put into that company?

A. No, sir, not taking the whole amount — you are taking the whole amount, the total amount. Mrs. Fihe and you put about \$16,000.00 into it only.

Q. You heard the testimony here that we were the only ones who put money into the business?

A. Yes, I heard the testimony, yes, sir.

Mr. Fihe: That is all. Thank you.

Mr. Townsend: One more question, Mr. Propeck.

Redirect Examination

Q. (By Mr. Townsend): Are you familiar with audits that have been made from your personal experience by accounting firms? A. Yes, sir.

Q. Have you ever known of an accounting firm to go to the books and any correcting entries that they might make, to date these correcting entries back several years? [128]

(No response.)

Q. For example, they can perform an audit depending on the type of engagement for the specific years the client decides upon? A. Correct.

Q. For example, they might make an audit for the year 1955 and the client might say, "I am not certain of my records back in 1950, 1951, 1952 and

(Testimony of John J. Propeck.)

1953," and they would actually make an audit for the years that the client so specified.

But any entries that they might make to correct the income or the balance sheet as reflected by the company, originally back in those years, they would make solely to one account, because the books would have been completely closed?

A. They would not be entered on the various books.

Q. They would not be entered individually in any one of the accounts. They would show that in the general journal by making adjusting entries, showing income or loss which would be reflected in the earnings account, and they would not be entered as original entries?

A. No, sir, they would appear as auditor's adjustment—auditor's adjusting entries.

Mr. Townsend: No further questions.

Mr. Fihe: There are no further questions. Thank you very much, Mr. Propeck. [129]

The Court: Witness excused.

(Witness excused.)

Mr. Fihe: May I interject at this time one statement?

Mr. Townsend: Are you testifying as a witness, Mr. Fihe?

Mr. Fihe: Yes.

Whereupon,

ALBERT J. FIHE

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was examined and testified further as follows:

Direct Examination

The Witness: I would like to refer to Petitioner's Exhibit 7 and I wish to state here that I know of my own personal knowledge that while this document is dated October 1, 1946, it was actually not executed until some time in either the latter part of 1947 or the first part of 1948, and that was part of the reconstruction of these records.

And the transfer of some of this real estate which took place after all this trouble with the attempted perjury of the agent and in order to get some of this real estate straightened out, the four of us dated back this real estate transfer.

That is merely in rebuttal of Mr. Propeck's [130] statement, that they do not date these records back. I know for a fact that this one was.

That is all.

(Witness excused.)

Mr. Fihe: That probably closes the case. Does your Honor want briefs on these things?

Mr. Townsend: Your Honor, I have one point—if you recall in my opening statement, I made the point that the ninety day letter sets up as income received from the corporation in 1947, items classi-

fied as dividends, items classified as royalties—it is rather difficult to determine just exactly what they are.

It appears from the proof that some of it represents salary. However, there is an under-statement of income. Respondent would like to amend his pleadings, if that is necessary, to make that a lump sum as understated income without classifying the various items, if the Court feels that is necessary.

The Court: Well, I hesitate to advise the parties.

Mr. Townsend: May I have leave to amend them and to do that, your Honor?

The Court: Do you have your amendment *read*, Mr. Townsend?

Mr. Townsend: No, I am sorry I do not.

The Court: Well, I am afraid I will have to deny [131] you leave to do that.

Mr. Townsend: Very well then, your Honor.

The Court: I will ask for briefs in **sixty days** with twenty days thereafter to reply, if you want to.

Mr. Fihe: Shall we exchange briefs at the end of the sixty days?

The Court: If you file them with the Court, the Court will serve them on the other parties. And I would request that you be careful in setting out your proposed findings and facts.

Mr. Fihe: You want these with the briefs?

The Court: Yes, the rules provide for that.

Mr. Fihe: And may I, on behalf of myself and Mrs. Fihe, thank you very much for your very kind attention.

The Court: You are welcome.

(Whereupon, at 10:25 o'clock a.m., Tuesday, November 29, 1955, the hearing in the above-entitled matter was closed.) [132]

[Endorsed]: T.C.U.S. Filed December 12, 1955.

[Endorsed]: No. 15726. United States Court of Appeals for the Ninth Circuit. Albert J. Fihe and Elizabeth Fihe, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: September 27, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In The United States Court of Appeals
For The Ninth Circuit

No. 15726

ALBERT J. FIHE, ELIZABETH M. FIHE,
Husband and Wife, Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS

To the Honorable the Judges of the United States
Court of Appeals for the Ninth Circuit:

Petitioners above named submit herewith in accordance with Rule 17 (6) a statement of points on which they intend to rely in this appeal, as follows:

1. The Honorable Judge of the Tax Court erred in holding that Petitioners understated their business income for the years 1947 to 1949, inclusive, and erred in not allowing itemized and proper deductions in each of said years.
2. The Honorable Judge erred in holding that Petitioners understated income derived from the corporation known as Holly Molding Devices, Inc., of Chicago, Illinois, for the years 1947 and 1948. Petitioners assert that the corporate records were deliberately changed and falsified after Petitioners sold their interests and stock in the company.

3. The Tax Court erred in taking into consideration the fact that the then president of Holly Molding Devices, Inc., namely Harry H. Holly, was an ex-convict, having served a term in the federal penitentiary for attempted income tax evasion and also for actual bribing of an internal revenue agent. The statements and records of such a person should not be given precedence or preference over the word of a reputable attorney, sworn to uphold the Constitution, and especially as he actually reported Holly's wrongdoings to the Federal Bureau of Investigation and the Internal Revenue Department.

4. The Judge of the Tax Court erred in holding that the Petitioners did not invest at least \$35,000.00 to \$50,000.00 in the corporation's predecessor partnership known as Holly Molding Devices during the ten years of 1936 to 1945, inclusive, and in ruling that the Petitioners realized a long term capital gain of about \$80,000.00 when selling their stock in the corporation in 1948. Petitioners' profit was not over \$50,000.00, and was distributed over several years.

5. The Judge erred in assessing a negligence penalty against the Petitioners for each of the years 1946, 1947 and 1948, regardless of the fact that Petitioners' 1946 return was prepared by a firm of certified public accountants and regardless of the fact that Petitioners at the trial submitted books of record showing careful and individual entries for all their business transactions for the years 1947, 1948 and 1949, which corresponded with their returns for those years.

6. The Tax Court erred in ruling that the non-negotiable notes which Petitioners received when selling their stock in the corporation represented actual cash and taxed Petitioners accordingly. Payments on these notes extended over a period of more than three years, and taxes should accordingly have been so distributed. The Court erred in taxing the Petitioners on the entire sum in the year 1948, although payments were never assured and could not have been collected by Petitioners under any circumstances in the one year 1948.

7. The Court erred in determining a tax deficiency against the Petitioners of approximately \$7,000.00 for the year 1948, when, in fact, Petitioners experienced and reported a business loss of over \$20,000.00 in the year 1950, which should be applied as a carry-back to the year 1948. Petitioners' profits for 1948 were not substantial in any event.

8. The Judge erred in not recognizing the proven fact that Petitioners saved the United States Government untold sums of money in reporting the wrong-doings and fraudulent actions of Harry H. Holly, his company auditor and the Internal Revenue agent conspiring with them. The honesty and integrity of the Petitioners have been proven to be above reproach and any reasonable doubt should be resolved in Petitioners' favor.

A copy of this statement of points has today been mailed to Charles K. Rice, Esq., Assistant Attorney General, Tax Division, United States Department

of Justice, Washington 25, D. C., and another copy has been mailed to Nelson P. Rose, Chief Counsel, Internal Revenue Service, Washington 25, D. C.

Respectfully submitted,

October 9, 1957.

/s/ ALBERT J. FIHE,
Attorney for Petitioners-
Appellants.

[Endorsed]: Filed October 10, 1957. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON REVIEW

Honorable Paul P. O'Brien, Clerk, United States Court of Appeals for the Ninth Circuit, San Francisco, California, Sir:

In accordance with Rule 17 (6), Petitioners herein submit a designation of all of the record which is believed to be material to the consideration of this appeal as follows:

1. Petitioners' Exhibits 2 to 12, inclusive, and Respondent's Exhibits A to M, inclusive.
2. Individual income tax return of Elizabeth M. Fihe for the year 1946.
3. Letter from the office of the Regional Commissioner directed to Albert J. Fihe, dated Janu-

ary 14, 1954, advising determination of income tax liability for the year 1946.

4. Letter from the office of the Regional Commissioner directed to Albert J. and Elizabeth M. Fihe, dated January 14, 1954, advising determination of income tax liabilities for the years 1947, 1948 and 1949.

5. Petition filed by Albert J. Fihe in the Tax Court of the United States for redetermination of the tax deficiency for the year 1946.

6. Petition filed by Albert J. and Elizabeth M. Fihe in the Tax Court of the United States for redetermination of the tax deficiency for the years 1947, 1948, and 1949.

7. Answer filed by Commissioner of Internal Revenue to petition of Albert J. Fihe for redetermination of 1946 tax.

8. Answer filed by Commissioner of Internal Revenue to petition of Albert J. and Elizabeth M. Fihe for redetermination of 1947, 1948 and 1949 taxes.

9. Amendment to above answer.

10. Deposition of Frank H. Wiscons taken in Chicago on October 10, 1955.

11. Report of proceedings before the Tax Court of the United States in Los Angeles on November 28, and 29, 1955.

12. Computation for entry of decision filed by Respondent in Docket No. 52,394.

13. Computation for entry of decision filed by Respondent in Docket No. 52,396.

14. Petitioners' proposed findings in Dockets Nos. 52,394 and 52,396.

15. Petitioners' comments on computations submitted.

16. Motions filed by Petitioners, dated May 9, 1957.

17. Petition for rehearing, filed June 13, 1957.

18. Memorandum findings of fact and opinion.

19. Decision, Docket No. 52,394.

20. Decision, Docket No. 52,396.

21. Notice of filing of petition for review.

22. Petition for review.

23. Designation of contents of Record on Review.

A copy of this Designation of Contents of Record on Review has today been mailed to Charles K. Rice, Assistant Attorney General, Tax Division, United States Department of Justice, Washington 25, D. C.; and another copy has today been mailed to Nelson P. Rose, Chief Counsel, Internal Revenue Service, Washington 25, D. C.

Respectfully submitted,

Burbank, California, October 9, 1957.

/s/ ALBERT J. FIHE,

Counsel for Petitioners.

[Endorsed]: Filed Oct. 10, 1957. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION TO CONSIDER EXHIBITS
IN ORIGINAL FORM

To the Honorable Court:

It is hereby stipulated by counsel for the respective parties that, subject to the approval of this Court, that the exhibits be considered in their original form without the necessity of reproduction in the printed record.

Burbank, California, January 29, 1958.

/s/ ALBERT J. FIHE,
Attorney for Petitioners.

Washington, D. C., February 10, 1958.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Respondent.

[Endorsed]: Filed February 12, 1958. Paul P. O'Brien, Clerk.

No. 15,735 ✓

United States Court of Appeals
For the Ninth Circuit

NG YIP YEE,

Appellant,

VS.

BRUCE G. BARBER, District Director of
Immigration and Naturalization,

Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

BRIEF FOR APPELLEE.

ROBERT H. SCHNACKE,

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CHARLES ELMER COLLETT,

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Attorneys for Appellee.

FILED

AUG 11 1958

PAUL P. O'BRIEN, CLERK

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No. 15,735

**United States Court of Appeals
For the Ninth Circuit**

NG YIP YEE,

Appellant,

vs.

BRUCE G. BARBER, District Director of
Immigration and Naturalization,

Appellee.

**Appeal from the United States District Court for the
Northern District of California,
Southern Division.**

BRIEF FOR APPELLEE.

FACTS.

The appeal herein constitutes the third appeal to this Court in the matter of *Ng Yip Yee v. Barber*.

Appeal No. 1. On July 1, 1953 the American Consul at Hong Kong issued a passport to Ng Yip Yee. On August 20, 1953, the Secretary of State invalidated and revoked the passport; Ng Yip Yee arrived at San Francisco on August 27, 1953. He was then detained by appellee and held for hearing before a Special Inquiry Officer. On September 17, 1953 the hearing commenced. On September 15, 1953 appellant

filed a petition for a writ of habeas corpus. The contention was that he had initiated a proceeding before the State Department for determination of his citizenship and that the Secretary had made a determination by issuing the passport and that therefore the appellee had no power to detain him. The lower Court denied the writ and dismissed the petition. On appeal to this Court appellant Ng Yip Yee filed a motion for bail pending appeal. A countermotion to dismiss the appeal on the ground that the action below was premature was granted February 4, 1954. 210 F. 2d 613, cert. den. 347 U.S. 988.

Appeal No. 2. Subsequent to the disposition of Appeal No. 1, the administrative proceedings were completed. The Special Inquiry Officer's decision adverse to Ng Yip Yee was appealed to the Board of Immigration Appeals. The Board treated the hearing of the appeal as a trial de novo and reappraised the evidence adversely to the appellant. A petition for a writ of habeas corpus was filed seeking to have the decision of the Immigration and Naturalization Service set aside. The District Court denied the writ and dismissed the petition. On appeal to this Court, by opinion dated September 8, 1955, the decision was reversed on the ground that the Special Inquiry Officer had applied the wrong burden of proof. 225 F. 2d 707. This Court held that the Board of Immigration Appeals should have returned the case to the Special Inquiry Officer who heard the witnesses for his appraisal of the evidence applying the ordinary burden of proof. The writ of habeas corpus was

granted for this purpose, remanding the case back to the Special Inquiry Officer for rehearing.

Appeal No. 3. On the mandate of this Court in Appeal No. 2 the case was remanded to the Special Inquiry Officer. On February 16, 1956, a rehearing was held pursuant to the mandate and remand. The Special Inquiry Officer then made his appraisal of the evidence applying the ordinary burden of proof in accordance with the direction of this Court. Appellant was ordered excluded.

An appeal to the Board of Immigration Appeals was dismissed. Appellant on November 2, 1956 filed a petition for review of the administrative proceedings in the Court below. By order filed August 16, 1957 the relief prayed for was denied and the proceedings and order of the Immigration and Naturalization Service were approved. Findings of fact and conclusions of law dated August 29, 1957 were filed and entered September 10, 1957. On September 11, 1957 a judgment dated September 10, 1957 and filed on September 10, 1957, was entered; on September 20, 1957 the notice of the present appeal was filed.

JURISDICTION.

The notice of appeal appearing in the typewritten transcript at page 27 states:

“Notice is hereby given that on this 3rd day of September, 1957, plaintiff hereby appeals to the United States Circuit Court of Appeals for the

Ninth Circuit from the order of this Court dated on the 29th day of August, 1957.”

This notice was filed on September 20, 1957. It refers to an order dated *on* the 29th day of August. There is no order *dated* August 29, 1957. There is no order which could have been dated *on* the 29th day of August, 1957. The first order in the case was filed by the judge on August 16, 1957 (Tr. p. 21) and may be held by this Court to be the final order from which the appeal should have been noted. The findings of fact and conclusions of law (Tr. p. 23) were dated and filed on September 10, 1957. The judgment (Tr. p. 26) was dated and filed on September 10, 1957, and entered September 11, 1957.

Appellant has failed to file a notice of appeal from either the order of August 16, 1957 or the judgment entered September 11, 1957. The appeal should be dismissed.

Joy Allen v. Schnuckle, 253 F. 2d 195 (9th Cir.).

STATEMENT OF POINTS.

Appellant states two points on appeal.

(1) The Court erred in failing to allow appellant a re-hearing as provided for in the order of the Appellate Court.

(2) The Court erred in finding that there was no expression of prejudice by the Special Inquiry Officer.

ARGUMENT.

I.

APPELLANT WAS ACCORDED A REHEARING
PURSUANT TO THE MANDATE.

From appellant's brief, it would appear that there is reliance on an unstated premise, to-wit: upon the bare specification of error or statement of the point, the Appellate Court will sua sponte exhaustively examine the record and research the law regardless of whether or not the appellant has done so.

Appellant at page 5 of his brief says "we disagree with the interpretation given by the trial Court (Tr. p. 21), in that it denied the right given to appellant by the Court of Appeals to a new hearing."

The interpretation, disagreement with which is indicated, is contained in the quotation on page 5 of appellant's brief immediately preceding the above quoted sentence, to-wit:

"I do not read the Circuit's opinion (Ng Yip Yee v. Barber, 225 Fed. 2d 707) as an order directing a hearing de novo. It merely directs that the testimony be reheard and that all the documentary data be reincorporated into a new administrative hearing. This directive had been complied with."

Two cases are cited by appellant presumably in support of the said disagreement. They both are in accord with the trial Court's interpretation.

In *Rogers Const. Co. v. Alaska Ind. Bd.*, 116 F. Supp. 65 at page 66 after stating "A rehearing implies a re-examination and re-consideration" the judge

went on to say "there is nothing to rebut the presumption that the Board properly performed its function and heard evidence of jurisdictional facts not presented in support of the first claim from which I conclude that there was no rehearing in the strict sense." The plaintiff had contended that the award of the Board was upon a rehearing which it had no power to grant.

United States v. Bertelsen & Petersen Eng. Co., 98 F. 2d 132 was concerned with a petition for a rehearing in the Court of Appeals. On rehearing the case was "to be heard anew on the question to which the rehearing is limited."

The opinion in the second *Ng Yip Yee* appeal was filed September 8, 1955. Reference in the opinion was made to the prior decision of this Court in *Mar Gong v. Brownell*, 209 F. 2d 448, in holding that the Special Inquiry Officer had applied the wrong burden of proof.

Prior to the aforementioned decision of this Court in *Mar Gong*, the District Court, Northern District, California, held in *Ly Shew v. Dulles*, 110 F. Supp. 50 that the burden upon the claimant was heavier than the ordinary burden. On appeal to this Court the judgment of the District Court was vacated December 30, 1954, 219 F. 2d 413 and the cause remanded to the District Court with instruction to make new findings after applying the ordinary burden of proof. The District Court in accordance with the mandate reheard the matter by re-examining the record after hearing further argument by counsel. New findings and judg-

ment in favor of defendant were entered. On second appeal to this Court the judgment was affirmed and the appeal dismissed after the appellant confessed fraud November 16, 1956. No. 14,768.

In *Chow Sing v. Brownell*, 217 F.2d 140, this Court vacated a judgment in favor of the defendant and remanded with instruction to apply the ordinary burden of proof as in the *Ly Shew* case. The District Court reheard and re-examined after argument by counsel and entered judgment for the defendant. On a second appeal the judgment was affirmed. *Chow Sing v. Brownell*, 235 F.2d 602.

A similar decision was made in *Lee Shew v. Brownell*, 219 F. 2d 301 (Feb. 1, 1955). The District Court after rehearing and re-examining entered judgment for the defendant. No second appeal was taken.

In *Wong Gong Fay v. Brownell*, 224 F. 2d 717 (July 22, 1955) a similar procedure was again followed. The Court below entered a judgment in favor of defendant and on a second appeal the judgment was affirmed.

The only difference in the case at bar from the above series of cases is that the remand here was back to the Special Inquiry Officer.

Appellant has disclosed no error in the procedure.

II.

SPECIFICATION OF PREJUDICE IS WITHOUT MERIT.

Appellant's second specification is prejudice by the Special Inquiry Officer.

The statement of the Special Inquiry Officer at the commencement of the hearing is quoted:

"In granting this hearing *I propose to stand on the prior record*, which I now have before me and which consists of all the prior testimony and Exhibits entered of record in this proceeding together with subsequent briefs, arguments and written orders in all proceedings up to the time that the case was decided before the Court of Appeals mentioned at the outset of the proceedings. Do you have anything further to present?" (Italics appellant's.)

Appellant by his counsel then handed an affidavit of prejudice to the Special Inquiry Officer.

By italicizing, appellant has designated the portions of the Special Inquiry Officer's remarks which appellant considers to support his charge of prejudice. It would appear that, "*I propose to stand on the prior record*" constitutes the words which support the sentence, "It is clear from the words of the Hearing Officer that he had already prejudged and arrived at his decision at the very outset of the alleged hearing" (p. 6, line 23 appellant's brief).

There is no merit to this contention.

CONCLUSION.

It is respectfully submitted that this appeal is wholly without merit and frivolous and should be dismissed.

Dated, San Francisco, California,
August 5, 1958.

ROBERT H. SCHNACKE,
United States Attorney,

CHARLES ELMER COLLETT,
Assistant United States Attorney,

Attorneys for Appellee.

No. 15740 ✓

United States
Court of Appeals
for the Ninth Circuit

JACQUES ARTHUR GUBBELS,
Appellant,

vs.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los
Angeles, California,
Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division.

FILED

DEC 11 1957

No. 15740

United States
Court of Appeals
for the Ninth Circuit

JACQUES ARTHUR GUBBELS,

Appellant,

vs.

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Immigration and Naturalization Service, Los
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Appellee.

Transcript of Record

Appeal from the United States District Court for the
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

For Appellant:

ARTHUR J. PHELAN,
220 Bush Street,
San Francisco 4, California;

MARSHALL E. KIDDER,
448 South Hill Street,
Los Angeles 13, California.

For Appellee:

LAUGHLIN E. WATERS,
United States Attorney;

ARLINE MARTIN,
Assistant U. S. Attorney;
600 Federal Building,
Los Angeles 12, California.

In the United States District Court In and for the
Southern District of California, Central Division

No. 20481—WM

JACQUES ARTHUR GUBBELS,

Plaintiff,

vs.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los
Angeles, California,

Defendant.

COMPLAINT FOR JUDICIAL REVIEW

Plaintiff, Jacques Arthur Gubbels, complains of
the defendant and for cause of action alleges:

I.

This complaint is filed and these proceedings are
instituted against the defendant pursuant to Title
28, U.S.C.A., Section 2201 and Title 5, U.S.C.A.,
Section 1009, for a judgment declaring that plain-
tiff is not deportable from the United States.

II.

Plaintiff is detained at the Federal Correctional
Institution, Terminal Island, San Pedro, California,
within the jurisdiction of this Court. [2*]

III.

The defendant, Albert Del Guercio, is the duly ap-
pointed, qualified and acting District Director of the

*Page numbering appearing at foot of page of original Certified
Transcript of Record.

Immigration and Naturalization Service, Department of Justice, Los Angeles, California; that Francis Quebodeaux, Special Inquiry Officer, Immigration and Naturalization Service, Los Angeles District, and the members of the Board of Immigration Appeals, Washington, D. C., are, and at all times herein complained of were, executive officials within the Department of Justice.

IV.

The plaintiff is a native of Belgium, citizen of The Netherlands, 21 years of age, who was lawfully admitted to the United States for permanent residence on February 3, 1948, at New York, New York, and who has resided continuously in the United States since that time; that he last arrived in the United States at an unknown port on or about October, 1954, as a member of the Armed Forces of the United States.

V.

On or about October 4, 1955, there was served upon the plaintiff a warrant of arrest issued by the Immigration and Naturalization Service directing that plaintiff be taken into custody and granted a hearing to show cause why he should not be deported from the United States; that pursuant to such warrant, a hearing was accorded the plaintiff by Francis Quebodeaux, Special Inquiry Officer at San Pedro, California, on November 29, 1955; that on the same day, the said Special Inquiry Officer, Francis Quebodeaux, after making findings of fact and conclusions of law, ordered that plaintiff be de-

ported from the United States on the following ground, to wit:

“That the respondent is subject to deportation under Section 241(a)(4) of the Immigration and Nationality Act, in [3] that he at any time after entry, had been convicted of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct, to wit: steal and violation of the Uniform Code of Military Justice, Article 121, and by means of force and violence, steal in violation of the Uniform Code of Military Justice, Article 122.”

VI.

On or about June 12, 1956, the Board of Immigration Appeals dismissed the plaintiff's appeal from the aforesaid order of the Special Inquiry Officer, Francis Quebodeaux, dated November 29, 1955.

VII.

The administrative officials have committed errors of law in applying the deportation statute to the facts of the plaintiff's case, and such deportation proceedings were unfair and constitute a denial of due process of law, and there is no reliable, probative and substantial evidence in the deportation record sustaining the charge upon which plaintiff has been ordered deported, for the following reasons, among others:

1. The court-martial judgment, made in Germany on or about September 13, 1954, which is the basis for the deportation charge, is not a “convic-

tion" within the meaning of Section 241(a)(4) of the Immigration and Nationality Act of 1952.

2. The offenses covered by the said court-martial judgment do not involve moral turpitude.

3. The evidence does not establish that the offenses covered by the court-martial judgment [4] did not arise out of a "single scheme of criminal misconduct," as required by Section 241(a)(4) of the Immigration and Nationality Act of 1952.

VIII.

Plaintiff is informed and believes and therefore alleges that, unless the defendant is restrained from so doing, he will assume custody over the plaintiff on or about September 29, 1956, for the sole purpose of effecting plaintiff's deportation to The Netherlands.

Wherefore, plaintiff prays that the Court review the record of his deportation proceedings and enter judgment that he is not deportable from the United States on the charge contained in the order of deportation and that, pending such review, the Court enjoin and restrain the defendant from proceeding with the deportation of plaintiff.

ARTHUR J. PHELAN &
MARSHALL E. KIDDER,
Attorneys for Plaintiff,

By /s/ MARSHALL E. KIDDER.

Dated: September 18, 1956.

[Endorsed]: Filed September 19, 1956.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant herein, and in answer to the complaint on file herein, admits, denies and alleges as follows:

I.

Referring to the allegations contained in paragraph I of plaintiff's complaint, neither admits nor denies said allegations, the same being conclusions of law.

II.

Referring to the allegations contained in paragraphs II, VII and VIII, denies said allegations; and with further reference to paragraph II, alleges that the plaintiff is now at liberty on bond.

III.

Referring to the allegations contained in paragraphs III, [6] IV, V and VI, admits said allegations.

Wherefore, defendant prays that plaintiffs take nothing by reason of the complaint herein, that the Court enter an order determining the validity of the Deportation Order herein to be reviewed, for costs and for such other and further relief as to the Court seems proper.

LAUGHLIN E. WATERS,
United States Attorney;

MAX F. DEUTZ,
Assistant United States Attorney, Chief of Civil
Division;

ARLINE MARTIN,
Assistant United States
Attorney;

/s/ ARLINE MARTIN,
Attorneys for Defendant.

Affidavit of service by mail attached.

[Endorsed]: Filed October 22, 1956. [7]

[Title of District Court and Cause.]

PLAINTIFF'S PROPOSED
PRETRIAL ORDER

At a conference held under Rule 16, F.R.C.P., by direction of William M. Byrne, Judge, the following admissions and agreements of fact were made by the parties and require no proof:

(1) Plaintiff, Jacques Arthur Gubbels, is a native of Belgium, citizen of The Netherlands, born March 4, 1935, who was lawfully admitted to the United States for permanent residence at New York, N. Y., on February 3, 1948.

(2) Plaintiff enlisted in the United States Army when 17 years of age, and during the course of such service was sent to and stationed in Germany.

(3) On or about September 13, 1954, in Germany, he was convicted by general court-martial of violation of Article 121 of the Uniform Code of Military Justice, under a specification charging

that [9] did, at Rohrnbach, Germany, on or about March 16, 1954, steal a pistol, caliber .45, of a value of more than \$50.00, the property of the United States, and also convicted of a violation of Article 122 of the Uniform Code of Military Justice, pursuant to a specification charging that at Landshut, Germany, on or about August 2, 1954, by means of force and violence, steal from the person of J. R., against his will, an automobile of a value of more than \$50.00.

(4) On or about November 29, 1955, following the completion of a deportation hearing accorded plaintiff, the Special Inquiry Officer of the Immigration and Naturalization Service made the following Conclusion of Law and Order:

“Conclusion of Law

“Upon the basis of the foregoing findings of fact, it is concluded:

“(1) That the respondent is subject to deportation under Section 241(a)(4) of the Immigration and Nationality Act, in that he at any time after entry, had been convicted of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct, to wit: steal and violation of the Uniform Code of Military Justice, Article 121, and by means of force and violence, steal in violation of the Uniform Code of Military Justice, Article 122.

“Order: It is ordered that the alien be deported from the United States, in the manner provided by

law, on the charge contained in the warrant of arrest."

(5) On or about June 12, 1956, the Board of Immigration Appeals ordered that the appeal of plaintiff from the decision of the Special Inquiry Officer be dismissed.

Issues of Fact to Be Tried

There are no issues of fact to be tried. [10]

Issues of Law

(1) Is a conviction by court-martial sufficient to sustain a deportation charge under Section 241(a) (4) of the Immigration and Nationality Act (8 U.S.C.A. 1251(a)(4)) providing for the deportation of aliens who are convicted of crimes involving moral turpitude?

(2) Does a violation of Article 121 of the Uniform Code of Military Justice involve moral turpitude?

(3) Is there reasonable, substantial and probative evidence that the offenses committed by the plaintiff did not arise "out of a single scheme of criminal misconduct," one of the elements of the deportation charge?

The foregoing admissions of fact have been made by the parties in open court at the pretrial conference; and issues of fact and law being thereupon stated and agreed to, the court makes this Order

which shall govern the course of the trial unless modified to prevent manifest injustice.

Dated: March 11, 1957.

/s/ WM. E. BYRNE,
Judge of the U. S. District
Court.

The foregoing pretrial order is hereby approved:

LAUGHLIN E. WATERS,
United States Attorney;

MAX F. DEUTZ,
Ass't U. S. Attorney,
Chief of Civil Division;

ARLINE MARTIN,
Ass't. U. S. Attorney,
Attorneys for Defendant,

By /s/ ARLINE MARTIN.

ARTHUR J. PHELAN, and
MARSHALL E. KIDDER,
Attorneys for Plaintiff,

By /s/ MARSHALL E. KIDDER.

[Endorsed]: Filed March 11, 1957. [11]

[Title of District Court and Cause.]

MEMORANDUM OF DECISION

Gubbels seeks judicial review of a final administrative order directing his deportation on the charge that he is an alien who, after entry, has been convicted of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct.¹

The plaintiff Gubbels is a native of Belgium, a citizen of The Netherlands, born March 4, 1935, who last entered the United States at the port of New York, on February 3, 1948. He was admitted for permanent residence as a quota immigrant and has resided here continuously since such entry, except for absence abroad while in the service of the armed forces of the United States.

In 1952 plaintiff enlisted in the United States Army. On September 13, 1954, while serving in the army and stationed in Germany he was convicted in a general court-martial of violation of Article 121 of

¹Section 241(a)(4) of the Immigration and Nationality Act of 1952 (8 U.S.C. 1251(a)(4)),

“(a) Any alien in the United States [including an alien crewman] shall, upon the order of the Attorney General, be deported who * * *

“(4) * * * at any time after entry is convicted of two crimes involving moral turpitude, not arising out of a single scheme of criminal misconduct, regardless of whether confined therefor and regardless of whether the convictions were in a single trial;” [12]

the Uniform Code of Military Justice, in that he did at Rohrbach, Germany, on or about March 16, 1954, steal a pistol, caliber .45, of a value of more than \$50.00, the property of the United States. At the same court-martial he was charged and convicted of a second offense, viz., violation of Article 122 of the Uniform Code of Military Justice, in that at Landshut, Germany, on or about August 2, 1954, by means of force and violence, he did steal from the person of J. R., against his will, an automobile of a value of more than \$50.00. He was sentenced to confinement at hard labor for five years and dishonorable discharge. Following incarceration in the Federal Correctional Institution at Terminal Island, California, he was paroled on September 29, 1956.

The basic question for decision is whether a conviction by a military tribunal is a "conviction" within the meaning of § 241(a)(4) of the Immigration and Nationality Act (8 U.S.C. 1251(a)(4)). The question has never been decided in any reported case. It was present in *United States ex rel. Parenti vs. Martineau*, 50 F. 2d 902 (D.C.D. Conn.), but the court found it unnecessary to decide the point, and rested its decision on other grounds.

To support his contention that Congress did not intend that court-martial convictions should be included within the meaning of "convictions" as used in § 241(a)(4), Gubbels points to the distinctions between military tribunals and civil courts with particular emphasis on the right to jury trial in a civil

court. Most of these distinctions are real, but [13] they do not aid in the resolution of this problem. The distinctions were well known to Congress and had it desired to write them into the Act it would have done so. No distinction was made between "convictions" in jury trial and "convictions" in court trial, just as no distinction was made with respect to "convictions" in federal, state, territorial and military courts.

Although military tribunals form no part of the judicial system of the United States, they possess the same full, complete and plenary power over offenses committed within their jurisdiction as the civil courts of the country do in theirs. Mr. Justice Harlan, speaking for the Court in *Grafton vs. United States*, 206 U.S. 333, 345, stated: "It is alike indisputable that if a court-martial has jurisdiction to try an officer or soldier for a crime, its judgment will be accorded the finality and conclusiveness as to the issues involved which attend the judgments of a civil court in a case of which it may legally take cognizance."

In the *Grafton* case, *Grafton*, a private in the Army of the United States, was convicted of homicide in a civil court of the Philippine Islands. He had previously been acquitted of an offense based upon the same acts when tried before a general court-martial. The *Grafton* court held that "the same act constituting a crime against the United States cannot, after the acquittal or conviction of

the accused in a court of competent jurisdiction, be made the basis of a second trial of the accused for that crime in the same or in another court, civil or military, of the same government.”

To assert that a conviction by court-martial which is a bar to prosecution in the civil courts is not a “conviction” within the meaning of §241(a)(4) is untenable. Congress has [14] chosen to confer upon courts-martial authority to try an officer or soldier for any crime committed by him in the territory in which he is serving. In most instances this jurisdiction is concurrent with that of the civil courts and a prosecution by court-martial is a bar to prosecution in the civil courts. While the Constitutional rule against double jeopardy is not infringed by prosecution and punishment in both the Federal and state courts, as they are distinct offenses (*Herbert v. Louisiana*, 272 U. S. 312, 47 S. Ct. 103, 71 L. Ed. 270), most states have adopted statutes similar to California Penal Code §793, which provides: “When an act charged as a public offense is within the jurisdiction of another state or country, as well as of this state, a conviction or acquittal thereof in the former is a bar to the prosecution or indictment therefor in this state.” Construing a statute similar to California Penal Code §793, the Criminal Court of Appeals of Oklahoma in *State v. Mills*, 82 Okla. Cr. 282, 163 P. 2d 558, rejected the argument that a court-martial is not a court within the meaning of the statute and held that where one is charged and tried by court-martial

it is a bar to another prosecution in the state courts. It would produce an incongruity to hold that Congress intended that a "conviction" within the meaning of §241(a)(4) would depend upon which court first took hold of the case.

Deportation is a drastic measure and in construing a statute with several possible meanings we should select the one most generous to the alien (*Fong Haw Tan v. Phelan*, 333 U. S. 6, 68 S. Ct. 374; 92 L. Ed. 433), but where a fair reading of the statute leaves it unambiguous, it is the duty of the court to give coherence to what Congress intended. Congress made no distinction between convictions in civil courts [15] and military courts and intended none.

It is clear that the two offenses did not arise "out of a single scheme of criminal misconduct." The first offense was the theft of a pistol from the United States Government at Rohrbach, Germany, March 15, 1954. Five months later, on August 2, 1954, at Landshut, Germany, the alien stole an automobile from an individual by means of force and violence. There was no connection between the two offenses, both of which involved moral turpitude. See *U. S. ex rel. Parenti v. Mortineau*, 50 F. 2d 902 (D. C. D. Conn.); *Bartos v. United States*, 19 F. 2d 722 (CCA 8).

Judgment will be for the defendant whose counsel is directed to prepare, serve and lodge findings and judgment in accordance with local Rule 7.

June 12, 1957.

/s/ WM. M. BYRNE,

United States District Judge.

[Endorsed]: Filed June 12, 1957. [16]

United States District Court for the Southern
District of California, Central Division

Civil No. 20481-WB

JACQUES ARTHUR GUBBELS,

Plaintiff,

vs.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los
Angeles, California,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF
LAW, AND JUDGMENT

The above matter having come on for trial on Monday, April 22, 1957, at 2 o'clock p.m., before the Honorable William M. Byrne, United States District Judge, plaintiff appearing by his attorneys, Arthur J. Phelan and Marshall E. Kidder, defendant appearing by his attorneys, Laughlin E. Waters, United States Attorney, Richard A. Lavine and Arline Martin, Assistants United States Attorney, and a certified copy of the Immigration and Naturalization proceedings having been introduced

into evidence as Defendant's Exhibit A for review by the Court, and the matter having been argued both orally and upon written memoranda, and having been submitted to the Court for decision, and the Court being fully advised and having heretofore, on June 12, 1957, filed its Memorandum of Decision, [17] makes the following Findings of Fact, Conclusions of Law, and Judgment:

Findings of Fact

I.

Jurisdiction is invoked for declaratory judgment of review of a final deportation order under the provisions of Title 28, U.S.C. §2201, and Title 5, U.S.C. § 1009.

II.

The defendant, Albert Del Guercio, is the duly appointed, qualified and acting District Director of the Immigration and Naturalization Service, Department of Justice, at Los Angeles, California.

III.

The plaintiff is a native of Belgium, a citizen of The Netherlands, and a resident of the County of Los Angeles, State of California, within the jurisdiction of this Court.

IV.

The plaintiff last entered the United States on or about October, 1954, and was lawfully admitted to the United States for permanent residence on February 3, 1948, at New York, New York.

V.

On or about September 13, 1954, in Germany, plaintiff was convicted by general court-martial of violation of Article 121 of the Uniform Code of Military Justice under a specification charging that he did, at Rohrnbach, Germany, on or about March 16, 1954, steal a pistol, caliber .45, of a value of more than \$50.00, the property of the United States, and was also convicted by a general court-martial of a violation of Article 122 of the Uniform Code of Military Justice, pursuant to a specification charging that at Landshut, Germany, on or about August 2, 1954, by means of force and violence, he did steal from the person of J.R., against [18] his will, an automobile of a value of more than \$50.00. Plaintiff was accorded hearings in deportation by the Immigration and Naturalization Service, and following the completion of said deportation hearings, and on or about November 29, 1955, the Special Inquiry Officer made the following conclusions of law and order:

Conclusions of Law

Upon the basis of the foregoing findings of fact, it is concluded:

(1) That the respondent is subject to deportation under Section 241(a)(4) of the Immigration and Nationality Act, in that he at any time after entry, had been convicted of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct, to wit: Steal and violation

of the Uniform Code of Military Justice, Article 121, and by means of force and violence, steal in violation of the Uniform Code of Military Justice, Article 122.

Order: It is ordered that the alien be deported from the United States, in the manner provided by law, on the charge contained in the warrant of arrest."

VI.

On or about June 12, 1956, the Board of Immigration Appeals ordered that the appeal of plaintiff from the decision of the Special Inquiry Officer be dismissed, and said order of deportation became final.

Conclusions of Law

I.

Plaintiff was accorded due process in all of the proceedings by the Immigration and Naturalization Service and in its findings and order of deportation, and said findings and order of deportation [19] are supported by reasonable, substantial and probative evidence and were according to law, and are affirmed, and judgment should be entered accordingly.

II.

The two convictions above found by general court-martial were convictions within the meaning of Section 241(a)(4) of the Immigration and Nationality Act [8 U.S.C. 1251(a)(4)].

III.

Each of the two offenses of which plaintiff was convicted by general court-martial involved moral turpitude.

IV.

The two offenses of which the plaintiff was convicted by general court-martial did not arise out of a single scheme of criminal misconduct within the meaning of Section 241(a)(4) of the Immigration and Nationality Act [8 U.S.C. 1251(a)(4)].

Judgment

In accordance with the foregoing Findings of Fact and Conclusions of Law,

It Is Ordered, Adjudged and Decreed that the final order of deportation of the plaintiff herein by the Immigration and Naturalization Service is a valid order, and the injunction and other relief prayed for by the plaintiff is hereby denied, with costs to the defendant in the sum of \$20.00 as and for a docket fee, pursuant to 28 U.S.C. §1923.

Dated: July 3, 1957.

/s/ WM. M. BYRNE,

United States District Judge.

Affidavit of service by mail attached.

Lodged June 21, 1957.

[Endorsed]: Filed and entered July 3, 1957. [20]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Jacques Arthur Gubbels, plaintiff herein, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from the judgment in the above-entitled action against plaintiff and in favor of defendant which said judgment was entered in this action on July 3, 1957.

ARTHUR J. PHELAN and
MARSHALL E. KIDDER,
Attorneys for Plaintiff,

By /s/ MARSHALL E. KIDDER.

Receipt of copy acknowledged.

[Endorsed]: Filed August 27, 1957. [22]

[Title of District Court and Cause.]

STIPULATION REGARDING ORIGINAL EXHIBITS

It Is Hereby Stipulated by and between the parties hereto through their respective counsel, that the original exhibits introduced at the trial of the action, may be considered in their original form by the United States Court of Appeals for the Ninth Circuit in connection with the pending appeal and need not be printed.

Dated this 7th day of October, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

RICHARD A. LAVINE,
Assistant U. S. Attorney,
Chief Civil Division;

ARLINE MARTIN,
Assistant U. S. Attorney,
Assistant Chief of Civil Div.;

By /s/ ARLINE MARTIN.

ARTHUR J. PHELAN and
MARSHALL E. KIDDER,
Attorneys for Plaintiff,

By /s/ MARSHALL E. KIDDER.

[Endorsed]: Filed October 7, 1957. [27]

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit in the above-entitled matter:

A. The foregoing pages numbered 1 to 27, inclusive, containing the original:

Complaint.

Answer.

Plaintiff's Proposed Pretrial Order.

Memorandum of Decision.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Appeal.

Designation of Contents of Record on Appeal.

Stipulation Regarding Original Exhibits.

B. Defendant's Exhibit "A."

I further certify that my fee for preparing the foregoing record, amounting to \$1.60, has been paid by appellant.

Witness my hand and the seal of said District Court, this 7th day of October, 1957.

JOHN A. CHILDRESS,

Clerk;

[Seal] By /s/ **WM. A. WHITE,**

Deputy Clerk.

[Endorsed]: No. 15740. United States Court of Appeals for the Ninth Circuit. Jacques Arthur Gubbels, Appellant, vs. Albert Del Guercio, as District Director, Immigration and Naturalization Service, Los Angeles, California, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed October 9, 1957.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15740

JACQUES ARTHUR GUBBELS,

Appellant,

vs.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los
Angeles, California,

Appellee.

STATEMENT OF POINTS UPON WHICH
APPELLANT RELIES

Jacques Arthur Gubbels, as appellant herein, presents herewith the following statement of points upon which he intends to rely on appeal.

The District Court erred in concluding as a matter of law that:

1. The findings and order of deportation are supported by reasonable, substantial and probative evidence.
2. The two convictions found by general court-martial were "convictions" within the meaning of Sec. 241(a)(4) of the Immigration and Nationality Act (8 U.S.C. 1251(a)(4)).
3. Each of the two offenses of which appellant was convicted by general court-martial involved moral turpitude.

4. The two offenses of which the appellant was convicted by general court-martial did not arise out of a single scheme of criminal misconduct within the meaning of Sec. 241(a)(4) of the Immigration and Nationality Act (8 U.S.C. 1251(a)(4)).

5. The appellee is entitled to judgment and costs.

ARTHUR J. PHELAN and
MARSHALL E. KIDDER,
Attorneys for Appellant,

By /s/ MARSHALL E. KIDDER.

Receipt of copy acknowledged.

[Endorsed]: Filed October 10, 1957.

Dated: October 7, 1957.

No. 15,740

IN THE

United States Court of Appeals
For the Ninth Circuit

JACQUES ARTHUR GUBBELS,
Appellant,

vs.

ALBERT DEL GUERCIO, as District
Director, Immigration and Natu-
ralization Service, Los Angeles,
California,
Appellee.

APPELLANT'S REPLY BRIEF.

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MAR 7 1958

PAUL P. O'BRIEN, CLERK

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No. 15,740

IN THE

**United States Court of Appeals
For the Ninth Circuit**

JACQUES ARTHUR GUBBELS,
Appellant,

vs.

ALBERT DEL GUERCIO, as District
Director, Immigration and Natu-
ralization Service, Los Angeles,
California,
Appellee.

APPELLANT'S REPLY BRIEF.

I.

- (a) **THE WORDS USED IN THE DEPORTATION STATUTE CAN-
NOT BE INTERPRETED AS EMBRACING PROCEEDINGS OF
A COURT-MARTIAL.**

Appellee's brief does not touch the real issue in this case. The question is simply one of interpretation of the deportation statute (8 U.S.C. 1251(a)(4), (b)). The test to be applied in that interpretation has been settled by the Supreme Court of the United States: The interpretation must be "that which is required by the narrowest of several possible meanings of the words used" (*Fong Haw Tan v. Phelan*, 333 U.S. 6, 68 S.Ct. 374, 92 L.Ed. 433).

Do the words of the statute in their "narrowest" meaning necessarily include judgments of a court-martial?

This is the sole question with which we are confronted in this problem of interpretation of the deportation statute.

It may help to get down to the nub of the matter by stating what is *not* involved. The power, authority, and jurisdiction of the court-martial is not in question. The finality of its decisions is not disputed. The legality of its proceedings is not under attack.

Appellant simply contends that the use of the word "court" in the deportation statute does not by the "narrowest" meaning of that word include a court-martial. The situation is strikingly similar to that involving use of the word "court" in a criminal statute, exemplified by the case of *Todd, et al. v. United States*, 158 U.S. 278, 15 S.Ct. 889. In that case the statute (R.S. Section 5406) punished any person who might injure a witness for having testified to any matter pending in a "Court" of the United States. It was held by the Supreme Court that injuring a witness who had testified in a preliminary examination before a Commissioner was not within the purview of the statute. In that case the Court said:

"While a preliminary examination may be, in the strictest sense of the term, a judicial proceeding, yet the language of the statute is not broad enough to include every judicial proceeding held under the laws of the United States."

In that case the Supreme Court cited with approval the earlier case of *United States v. Clark*, 1 Gall. 497, Fed. Cas. No. 14804, in which the indictment was for perjury on a preliminary examination before a Judge of the United States District Court under a statute which punished perjury in any suit, controversy, matter or cause depending in any of the "courts" of the United States. In the *Clark* case, the Court said:

"The statute does not punish every perjury but only a perjury done in a Court of the United States. Primarily, therefore, it is of the essence of the offense that it should be charged as committed in such court."

The conclusion was that perjury before a judge on a preliminary examination was not perjury in a "court" of the United States within the meaning of those words in the criminal statute then under consideration.

In those cases, the statutory reference to a "court" was so narrowly construed that even proceedings before a Judge or Commissioner sitting in a magisterial capacity were held not to be included within the operation of the statute. Similar tenets of strict construction apply here (*Fong Haw Tan v. Phelan*, supra), and certainly there is far less reason to interpret the reference to "the court" in the statute here under discussion as including a court-martial.

Appellee does not attempt to contend that the word "court" includes a court-martial when used in the ordinary sense in legislative enactments, but he does

say that such tribunals “are judicial in nature” and perform a “judicial function.” But this is simply a play upon one of the several meanings in which the adjective “judicial” is used. This becomes eminently clear from an examination of the decision on which appellee places his principal reliance, viz., *Runkle v. United States* (1887), 122 U.S. 543, 557, 7 S. Ct. 1141, 30 L.Ed. 1167. In that case the question was whether the President could delegate a duty imposed upon him by statute to review court-martial proceedings in certain cases and approve or disapprove the action of the military tribunal. The court held that this was not an act which the President could delegate to a subordinate because the action required is “judicial in its character, not administrative” and “his personal judgment is required, as much so as it would have been in passing on the case if he had been one of the members of the court-martial itself.” Here the court was using the word “judicial” in a sense in which it is frequently used, as distinguishing action of an officer or tribunal which requires personal judgment in contradistinction to ministerial or administrative actions. As stated in 50 *Corpus Juris Secundum*, page 565:

“The term ‘judicial act’ is employed in law in two distinctly different senses * * * one, a broad sense indicating an act in the performance of which discretion and judgment are to be exercised; the other, a more technical sense, relating to an act of the judiciary * * *.

“When the term is employed in its broad, general meaning, it is the nature or quality of the

act which determines whether it is judicial and not the character of the person or instrumentality authorized to perform it. So used, it means official action which is the result of judgment or discretion; an official act in the performance of which it is necessary to consider and pass on evidence, and to arrive at a determination with respect thereto * * *."

The reference in the opinion in the *Runkle* case to a court-martial acting judicially and to "acts of a court," upon which appellee appears heavily to rely, is actually quoted from an opinion of the Attorney General (11 Opn. Attys. Gen. 19, 20-21), and if the language of that opinion is examined, it is definitely shown that the Attorney General was using these expressions to indicate acts involving discretionary determinations of fact and of law, as distinguished from administrative actions. In that opinion the Attorney General said: "I have quoted article 20th because it shows that Congress intended that the official who is authorized to approve and confirm the sentence of the court-martial under this Act, in revising its proceedings should act *judicially*—THAT IS, THAT HE SHOULD EXERCISE THE DISCRETION CONFIDED TO HIM WITHIN THE LIMITS OF THE LAW."

Of course a military tribunal, when acting in a matter within its jurisdiction, acts "judicially" in this sense, and in the sense that its decision carries finality and is impervious to collateral attack. Many other commissions, boards, officers, and other tribunals

also act judicially in that sense in adjudicating matters which fall within their jurisdiction, and their decisions may be just as impervious to collateral attack. Yet this does not make them a part of the judicial branch of the Government, nor does it make them "courts" within the meaning of a statutory provision which contains the word "court" without more.

Nor are the "dignity and finality" of judgments of the court-martial system in question here. We do not question the conclusiveness of the military tribunal's action in this case, nor the propriety of its procedures. The adequacy of the procedural safeguards which Congress has prescribed in court-martial proceedings is not in dispute. Congress has made similar provisions in connection with other types of proceedings before other types of tribunals which are not "courts" in the usual sense. None of these considerations so touched upon in appellee's brief reaches the real question which is whether Congress in the deportation statute in referring to a "court" intended to include a military tribunal.

"Thus indeed, strictly, a court-martial is not a *court* in the full sense of that term, or as the same is understood in the civil phraseology. It has no common law powers whatever, but only such powers as are vested in it by express statute, or may be derived from military usage. None of the statutes governing the jurisdiction or procedure of the 'Courts of the United States' have any application to it; * * * it is indeed a creature of *orders*, and except in so far as an independent discretion has been given it by statute, it is as

much subject to the orders of a competent superior as is any military body or person.”

Vol. 1, *Winthrop's Military Law and Precedents* (2nd edition) page 54.

As recently as last term, the Supreme Court of the United States said

“Courts-martial are typically *ad hoc* bodies appointed by a military officer from among his subordinates * * *. In essence, these tribunals are *simply executive tribunals* whose personnel are in the executive chain of command.” (Italics added.)

Reid v. Covert, 354 U.S. 1, 77 S. Ct. 1222, 1241, 1 L.Ed. (2d) 1148.

The foregoing decision is in line with many others wherein the Supreme Court of the United States has had occasion to point out and emphasize the fact that courts and military tribunals are generically different, notwithstanding the fact that each may be supreme in its own jurisdictional field.

Duncan v. Kahanamoku, 327 U.S. 304, 66 S.Ct. 606, 90 L.Ed. 688;

In re Vidal, 179 U.S. 126, 21 S.Ct. 48, 45 L.Ed. 118;

Yamashita v. Styer, 327 U.S. 1, 66 S.Ct. 340, 344, 90 L.Ed. 499.

In enacting statutes of general application, Congress itself has not regarded military tribunals as being included within the word “courts”: For example, in the Administrative Procedure Act (5 U.S.C.

1001(a)), the statute defines “agency” as each authority of the Government of the United States *other than* Congress, *the courts*, or the governments of the possessions, territories or the District of Columbia, but in the same section Congress found it necessary to use additional specific language to exclude agencies such as “courts-martial and military commissions.”

It would seem to be self-evident that the language of the deportation statute here involved does not encompass proceedings before military tribunals within its scope, particularly since the words of this statute must be given their narrowest interpretation. On the contrary, it would be necessary to stretch the language far beyond its ordinary meaning to sustain the deportation order involved in this case. The plain fact is that a military tribunal is not a court as that term is used in a general statute of this sort, and dissertations as to the general powers of such bodies are wholly inapposite to the question here presented.

(b) THE PROVISION REGARDING RECOMMENDATION OF THE COURT CANNOT RELATE TO MILITARY TRIBUNALS.

Appellee’s argument regarding subdivision (b)(2) of the statute is based upon two major misconceptions. First, he undertakes to assume that appellant’s contention is “that said machinery is defective.” There is no such contention. Appellant’s contention is that the subsection can and does relate only to a court and not to a military tribunal, i.e., that military tribunals were not in contemplation of Congress

in enacting the statute. Furthermore, appellee's hypothesis that a court-martial could conceivably and practically exercise the statutory power to preclude deportation, loses sight of several concomitants of that statutory power, viz.:

1. The power must be exercised by "the court";
2. The power is self-executing and conclusive. Although referred to as a recommendation of the court, it is a positive adjudication which precludes the executive from deporting the accused;
3. The power can only be exercised within thirty days after first imposing judgment or passing sentence. This time limitation is mandatory (*U.S. ex rel. Klonis v. Davis* (CA 2) 13 F.2d 630);
4. Within that period there must be notice to the United States Immigration and Naturalization Service and opportunity for it to be heard by the court before such recommendation can be made.

With the foregoing limitations of the statute in mind, the best proof that military tribunals could not be in contemplation is appellee's concession at page 16 of his brief that in the court-martial procedure "the powers of the ordinary criminal court are split among the court-martial, the convening officer, and appellate authorities." We would also point out, as the Supreme Court of the United States has recently observed, that members of the armed forces of the United States are now stationed in sixty-three foreign countries in which these *ad hoc* military tribunals are convened from time to time. From the very nature of the problem, it is difficult to see how

the provisions of subsection (b)(2) of the statute could possibly be carried out if military tribunals are considered to be within its scope. The time limit alone would seem to make such a course impossible of application to such proceedings; the nature and function of the tribunal would seem to be incompatible with the thought that it should exercise this statutory prerogative; and certainly there is no indication of an intent to include military reviewing authorities within the words "the court" in that subsection, nor is it claimed that any provision for such a procedure has been made in any of the regulations pertaining to procedures of military tribunals. In short, we submit that subsection (b)(2) of the statute cannot be reconciled with the hypothesis that proceedings of military tribunals are within the scope of the deportation statute. It is reasonable to assume that if Congress had so intended, there would be words which would make that intention clear, including some workable provision whereby the exclusionary benefits of subsection (b)(2) would be implemented in cases involving military personnel tried by military tribunals. It is perhaps superfluous to observe that so harsh a consequence as deportation should not be permitted to rest upon an ambiguity, and certainly an intention to have such tribunals function as "the court" in making the statutory adjudications prescribed by subsection (b)(2), *supra*, as to whether or not aliens shall be deported cannot be attributed to Congress on the basis of the language used.

(c) THE INTENTION OF CONGRESS TO INCLUDE COURT-MARTIAL PROCEEDINGS DOES NOT APPEAR.

The attempt to apply the deportation statute, as now written, to individuals who may have been found guilty of infractions by military tribunals of the United States armed forces in any of the sixty-three countries of the world in which such armed forces are now stationed, presents such anomalies that there would seem to remain no question as to the inapplicability of the statute to such situations. Apart from the practical impossibility of applying the present subsection (b)(2) to court-martial proceedings, there are other obvious difficulties. A soldier may be convicted of infractions which in civil life would amount to no more than a civil wrong or which might be treated as a juvenile delinquency rather than a crime, and if two separate charges were involved, the soldier would be subject to deportation regardless of whether or not any punishment was imposed by the military tribunal. We have pointed out that at least up to the enactment of the Immigration and Nationality Act of 1952, the administrative authorities found it impossible under the law to sustain deportation in cases of members of the United States armed forces convicted on foreign soil by court-martial, since the statute at that time used the words "in this country" with reference to deportation on the basis of convictions of crime. If that situation has changed, it would be necessary to hold that the mere omission of the words "in this country" from the present statute was intended to bring such court-martial cases

within the ambit of the statute. Certainly this would be a far-fetched deduction. It is much more likely that the words "in this country" were regarded as unnecessary in view of the definition of the word "entry" which was being written into another portion of the statute. Certainly an intention to subject resident aliens to deportation on the basis of proceedings of military tribunals should rest upon a more definite expression of Congress.

II.

APPELLANT HAS NOT BEEN CONVICTED OF TWO CRIMES INVOLVING MORAL TURPITUDE WITHIN THE MEANING OF THE DEPORTATION STATUTE.

While the first charge of violation of Article 121 of the Uniform Code of Military Justice (50 U.S.C., former Section 715) specifies that appellant did "steal" a pistol which was the property of the United States, it is not otherwise indicated which of the two sections of that article was violated. As pointed out in appellant's opening brief, it is conceivable that a soldier could be convicted under this particular article for infractions which in civil life might amount to no more than a civil wrong, or at least an infraction lacking in the elements of baseness and depravity necessarily involved in the concept of moral turpitude. The Attorney General's holding in *Matter of P*—, Vol. I, Admin. Dec. under Immigration and Nationality laws, page 33, (erroneously misprinted in appellant's opening brief as page 3) is pertinent here. In

that case the court-martial had found, and the subject admitted, that he had stolen money from another soldier. The Attorney General was unable to find that he took it with criminal intent or that respondent's conduct in the army would have constituted a civil crime under Italian law.

This difficulty constitutes another reason for doubt that the provisions of the deportation statute are intended to be applicable to persons convicted under military law by military tribunals, since conduct which under military law might constitute a criminal offense could amount to something less if civil law were being applied by a civil tribunal.

III.

CONCLUSION.

It would stretch the bounds of the language of the deportation statute to interpret it as applying to judgments of military tribunals. As the Supreme Court of the United States has held, deportation of a resident alien is in the nature of a forfeiture or penalty and the statutory provisions therefor must be construed in their narrowest sense. So construed, it would appear to be impossible to interpret the present statute as being designed to deport military offenders tried by a court-martial. Because of the seriousness of the consequences and of the problems involved, the intention of Congress to bring about such a result would require language much less ambiguous

and uncertain in that regard than is contained in the present statute.

We respectfully submit that the decision of the court below was erroneous and should be reversed.

Dated, San Francisco, California,

March 6, 1958.

PHELAN & SIMMONS,

ARTHUR J. PHELAN,

MILTON T. SIMMONS,

MARSHALL E. KIDDER,

Attorneys for Appellant.

No. 15740
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

JACQUES ARTHUR GUBBELS,

Appellant,

vs.

ALBERT DEL GUERCIO, as District Director, Immigration
and Naturalization Service, Los Angeles, California,

Appellee.

APPELLEE'S BRIEF.

LAUGHLIN E. WATERS,
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FILED

FEB 17 1958

PAUL P. O'BRIEN, CLERK

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No. 15740

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JACQUES ARTHUR GUBBELS,

Appellant,

vs.

ALBERT DEL GUERCIO, as District Director, Immigration
and Naturalization Service, Los Angeles, California,

Appellee.

APPELLEE'S BRIEF.

Jurisdiction of the Court.

This is an appeal from a judgment of the court below in an action for judicial review of an order of deportation. [Tr. 17-21.] Jurisdiction was invoked pursuant to 28 U.S.C. 2201, 5 U.S.C. 1009 [Tr. 3], and 8 U.S.C. 1329. Since the Order of the Court below was a final decision, this court has jurisdiction of an appeal from that decision pursuant to 28 U.S.C. Sec. 1291.

Statement of the Case.

Appellant, a 22-year-old native of Belgium and citizen of the Netherlands, arrived in the United States with his parents February 3, 1948, at the age of 12, and was admitted for permanent residence. In 1952 he enlisted in the United States Army. On September 13, 1954, while serving in Germany, he was convicted of two offenses.

The first offense of which he was convicted by court-martial was larceny, a violation of Article 121 of the Uniform Code of Military Justice, in that he did at Rohrbach, Germany, on March 16, 1954, steal a pistol which was the property of the United States and of a value of more than \$50. The second offense was robbery, a violation of Article 122 of the Uniform Code of Military Justice, in that at Landshut, Germany, on August 2, 1954, by force and violence, and against the will of the owner, he stole an automobile of a value more than \$50. He was sentenced to dishonorable discharge and confinement for five years. He was thereafter incarcerated in the federal correctional institution at Terminal Island, California, and on September 29, 1956, was paroled.

The action below was for review of a final administrative deportation order pursuant to hearings after warrant of arrest. The warrant charged that the plaintiff was subject to deportation pursuant to Sec. 241(a)(4) of the Immigration and Nationality Act of 1952 [8 U.S.C. 1251(a)(4)], in that at any time after entry he has been convicted of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct.

The District Court upheld the validity of the deportation order, and its opinion [Tr. 12-17] is reported at 152 F. Supp. 277.

Questions Presented.

1. Does the judgment of the court-martial constitute a "conviction" within the meaning of the deportation statute [8 U.S.C. 1251(a)(4)]?
2. Do the two crimes of which appellant has been convicted involve moral turpitude?

Statutes Involved.

Provisions of Sec. 1251(a)(4) of the Nationality Act read as follows:

§ 1251. *Deportable Aliens—General Classes*

“(a) Any alien in the United States (including an alien crewman) shall, upon the order of the Attorney General, be deported who— * * *

“(4) is convicted of a crime involving moral turpitude committed within five years after entry and either sentenced to confinement or confined therefor in a prison or corrective institution, for a year or more, or who at any time after entry is convicted of two crimes involving moral turpitude, not arising out of a single scheme of criminal misconduct, regardless of whether the convictions were in a single trial;

* * * * *

“(b) The provisions of subsection (a)(4) of this section respecting the deportation of an alien convicted of a crime or crimes shall not apply * * *

“(2) if the court sentencing such alien for such crime shall make, at the time of first imposing judgment or passing sentence, or within thirty days thereafter, a recommendation to the Attorney General that such alien not be deported, due notice having been given prior to making such recommendation to representatives of the interested State, the Service and prosecution authorities, who shall be granted an opportunity to make representations in the matter.

* * *

Articles 121 and 122 of the Uniform Code of Military Justice (formerly 50 U.S.C. 715, 716; now 10 U.S.C. 921, 922) read as follows:

“§ 715. Larceny and wrongful appropriation (article 121)

“(a) Any person subject to this chapter who wrongfully takes, obtains, or withholds, by any means whatever, from the possession of the true owner or of any other person any money, personal property, or article of value of any kind—

“(1) with intent permanently to deprive or defraud another person of the use and benefit of property or to appropriate the same to his own use or the use of any person other than the true owner, steals such property and is guilty of larceny; or

“(2) with intent temporarily to deprive or defraud another person of the use and benefit of property or to appropriate the same to his own use or the use of any person other than the true owner is guilty of wrongful appropriation.

(b) Any person found guilty of larceny or wrongful appropriation shall be punished as a court-martial may direct.”

* * * * *

“§ 716. *Robbery (Article 122)*

“Any person subject to this chapter who with intent to steal takes anything of value from the person or in the presence of another, against his will, by means of force or violence or fear of immediate or future injury to his person or property of a relative or member of his family or of anyone in his company at the time of the robbery, is guilty of robbery and shall be punished as a court-martial may direct.”

Herein, the Uniform Code of Military Justice, 50 U.S.C. 551-736 (1952 edition), 64 Stat. 108, Act of May 5, 1950, now recodified at 10 U.S.C. 801-940, 70A Stat. 36, Act of August 10, 1956, is cited as "UCMJ."

The Manual for Courts-Martial, prescribed by Executive Order No. 10214, February 8, 1951, 16 FR 1303 is cited as "MCM."

Summary of Argument.

I.

CONVICTION BY A COURT-MARTIAL CONSTITUTES A CONVICTION WITHIN THE MEANING OF THE DEPORTATION STATUTES.

- A. The "Executive Instrumentality" Concept Is Not Valid Because a Court-martial Is Not a Mere "Instrumentality" of the Executive.
- B. "Executive Instrumentality" Theory Suffers Final Defeat With Creation of Uniform Code of Military Justice.
- C. Military Tribunals Constitute a Parallel System to the State and Federal Courts and Are Accorded Equal Dignity.
- D. Court-martial Organization and Practice Is Appropriately Judicial.
- E. The Necessary Recommendation Under the Statute Can Be Made.
- F. There Is No Basis for Contention That Appellant's Court-martial Convictions Might Not Have Been Convictions in California.

II.

APPELLANT HAS BEEN CONVICTED OF TWO OFFENSES INVOLVING MORAL TURPITUDE.

ARGUMENT.

I.

Conviction by a Court Martial Constitutes a Conviction Within the Meaning of the Deportation Statutes.

The first question presented to this court is whether the judgment of the court-martial constitutes a conviction within the meaning of the deportation statutes [8 U.S.C. 1251(a)(4)]. The record shows clearly that appellant was in fact convicted by the court-martial of two crimes. The only question which can remain then, is whether the convictions suffered by appellant are somehow outside the meaning of "conviction" used in the statute.

Appellant cannot contend that he was convicted by the wrong type of court, for the statute makes no exception or distinction among types of tribunals rendering the conviction.

He is thus forced to create the argument that the court-martial is not a court. He contends that its function is not judicial, and therefore his convictions are not in fact convictions according to ordinary definitions and usage of the word. He alleges this theory despite the fact that these convictions actually placed him in a federal prison.

A. The "Executive Instrumentality" Concept Is Not Valid Because a Court-martial Is Not a Mere "Instrumentality" of the Executive.

Appellant must base his contention on the concept of courts-martial as an "executive instrumentality" in contrast with "Judicial instrumentality."

United States military history shows the existence of this old and now discredited theory that courts-martial

are merely instrumentalities of an executive agency, and that they exist merely to aid the military in establishing discipline. This concept was born among the American military in the post-Civil War era, and was soon denounced by the United States Supreme Court, *Runkle v. U. S.*, 122 U. S. 543. However, as it seemed to justify the then existing practices in the armed forces, it died a slow and hard death, and has since provoked academic discussion.

The accepted concept as pronounced by the Supreme Court is this: Courts-martial are instrumentalities created by legislative authority for the performance of a judicial function, and are not merely instrumentalities of the executive power for the enforcement of discipline.

It would seem without question that the purpose and function of a court-martial is the achievement of justice in the case before it. This achievement will certainly have as a by-product, a salutary effect upon discipline and morale. It is this by-product which led to the misconception of the nature of courts-martial. The genesis of the erroneous executive instrumentality concept has been traced to a misunderstanding of the holding by the United States Supreme Court in *Dynes v. Hoover*, 20 Haw. 65 (1858). In this case the Court stated that courts-martial were not to be classed with courts established under Article III of the Constitution. It then went on to point out that courts-martial were established by legislative authority contained in Article I of the Constitution. To the contrary of holding that courts-martial are not courts as that term is used in the usual sense, this case stands for the proposition that they are judicial in nature and are included in the judicial process.

Nineteen years after *Dynes v. Hoover*, the United States Supreme Court made it crystal clear that court-martial proceedings must be classified as judicial as contrasted with executive. This clear and unequivocal holding is set forth in *Runkle v. United States* (1887), 122 U. S. 543, 557; 7 S. Ct. 1141. However, during the period of time between *Dynes v. Hoover* and *Runkle v. United States*, the well known and much followed Winthrop treatise on courts-martial was published. In this work the author set forth at length the theory that courts-martial are not judicial in nature, but merely an executive instrumentality. See: *Winthrop, Military Law and Precedents*, page 54. Later commentators have observed that Col. Winthrop attempted to justify the existing army courts-martial practice by classifying it under the implied powers of the President. See *James W. Snedeker, "Military Justice under the Uniform Code,"* pages 43-48. This concept, together with an analogy to the British system of military justice, led to confusion as to the character of the American court-martial. As General Snedeker points out, the analogy to the British system overlooks the fact that the United States has a written Constitution, in which the power to make rules for the Government including provisions for the internal judicial process of the Armed Forces is placed in legislative, not executive hands as it is in Britain.

The holding of *Runkle v. United States* (*supra*) left no doubt that the executive instrumentality theory should be laid to rest. In this case the court set aside a court-martial conviction which had been approved in an administrative manner by the appropriate executive department head. The court said:

"There can be no doubt that the President, in the exercise of his executive power under the Constitu-

tion, may act through the head of the appropriate executive department. The heads of departments are his authorized assistants in the performance of his executive duties, and their official acts promulgated in the regular course of business, are presumptively his acts. That has been many times decided by this Court. (Citations.)

*“Here, however, the action required of the President is judicial in its character, not administrative. As Commander-in-Chief of the Army he has been made by law the person whose duty it is to review the proceedings of courts-martial in cases of this kind. This implies that he is himself to consider the proceedings laid before him and decide personally whether they ought to be carried into effect. Such a power he cannot delegate. * * *”* “* * * And this because he is the person, and the only person, to whom has been committed the important judicial power of finally determining on the examination of the whole proceedings of the court-martial, * * *.”

“‘Undoubtedly the President, in passing upon the sentence of a court-martial, and giving to it the approval without which it cannot be executed, acts judicially. *The whole proceedings from its inception is judicial. The trial, finding, and sentence are solemn acts of a court organized and conducted under the authority of and according to the prescribed forms of law.* * * * When the President, then, performs his duty on approving the sentence of a court-martial dismissing an officer, his act has all the solemnity and significance of the judgment of a court of law.’” (Emphasis added.)

B. "Executive Instrumentality" Theory Suffers Final Defeat With Creation of Uniform Code of Military Justice.

Congress finally wrote finish to the old executive instrumentality theory when in 1950 it enacted the Uniform Code of Military Justice. It was under this law that the appellant herein was tried and convicted of both violations. In this legislation, Congress provided for a court of military appeals. UCMJ, Art. 67(a). It provided an annual review of sentence policies of the armed forces, UCMJ, Art. 67(g); and specifically withheld final control from the executive by providing that the procedural regulations prescribed by the President be reported to Congress. UCMJ, Art. 36(b).

Then, completely exploding any remaining vestiges of the idea that court-martial trial of soldiers exists primarily to maintain discipline and is incidental to the Army's primary fighting function, Congress specifically provided for punishment of commanding officers who admonish or otherwise attempt unlawfully to influence the action of courts-martial. UCMJ, Arts. 37 and 98.

C. Military Tribunals Constitute a Parallel System to the State and Federal Courts, and Are Accorded Equal Dignity.

In rationalizing the theory that courts-martial are really not courts at all within the purview of 8 U.S.C. 1251(a)(4), emphasis is laid on various points of distinction between military courts and civil courts. Such differences no more place the courts-martial outside the definition of courts within the meaning of the statute than do the distinctions between federal, state, and local courts place any of them outside the bounds of the judicial system.

Judge Byrne in his holding below said:

“To support his contention that Congress did not intend that court-martial convictions should be included within the meaning of ‘convictions’ as used in Sec. 241(a)(4), Gubbels points to the distinctions between military tribunals and civil courts with particular emphasis on the right to jury trial in a civil court. Most of these distinctions are real, but they do not aid in the resolution of this problem. The distinctions are well known to Congress and had it desired to write them into the Act it would have done so. No distinction was made between ‘convictions’ in jury trial and ‘convictions’ in court trial, just as no distinction was made with respect to ‘convictions’ in federal, state, territorial and military courts.”

Granted that courts-martial are not strictly “courts of the United States” within the authority of Article III, it must be observed that neither are many of the other courts which are empowered to impose punishment for violations of criminal codes. For example, none of the courts of general criminal jurisdiction of any of the forty-eight states derive their powers from Article III of the Constitution. The criminal courts of the various territories of the United States and the District Courts of those territories are constituted not under Article III, but under Article IV, although their functions are substantially similar to the Article III courts. Congress established these territorial courts under its constitutional powers as it did the military courts-martial.

The fact that these non-Article III courts are part and parcel of the judicial system is not questioned. Neither can it be seriously contended that convictions of these courts do not in fact constitute convictions for the purposes of the Immigration and Nationality Act.

Just as judgments from courts of the state system are accorded the same dignity as those of the federal system, the judgment of the courts-martial system long have been accorded the same dignity and finality as those of other tribunals. In *Grafton v. United States*, 206 U. S. 333 (1907), the Supreme Court held that a soldier having been acquitted of homicide by a court-martial, could not then be tried by a civil territorial court. Such action would put him in double jeopardy. The court stated at page 345:

“It is alike indisputable that if a court-martial has jurisdiction to try an officer or soldier for a crime, its judgment will be accorded the finality and conclusiveness as to the issues involved which attend the judgments of a civil court in a case of which it may legally take cognizance. In *Ex parte Reed*, 100 U. S. 13, 23, the court referring to a court-martial, said: ‘The court had jurisdiction over the person and the case. It is the organism provided by law and clothed with the duty of administering justice in this class of cases. Having had such jurisdiction, its proceedings cannot be collaterally impeached for any mere error or irregularity, if there were such, committed within the sphere of its authority. Its judgments, when approved as required, rest on the same basis, and are surrounded by the same considerations which give conclusiveness to the judgments of other legal tribunals, including as well the lowest as the highest, under like circumstances.’

“But we rest our decision of this question upon the broad ground that the same acts constituting a crime against the United States cannot, after the acquittal or conviction of the accused in a court of competent jurisdiction, be made the basis of a second trial of the accused for that crime in *the same or in another court, civil or military, of the same government.*” (Emphasis added.)

It is thus clear that even decades before Congress codified it with finality in the Uniform Code of Military Justice, the United States Supreme Court followed the pronouncements of *Dynes v. Hoover* and *Runkle v. United States* (supra) in recognizing the true character of the court-martial as a tribunal of competent jurisdiction within the judicial process.

It should be observed that the *dicta* of Justice Black in *U. S. ex rel. Toth v. Quarles*, 350 U. S. 11, as quoted by appellant was written in a case involving the trial by court-martial of civilians. The issue there has no bearing on the issue here. *Dicta* in cases involving issues of Constitutional law must be considered in the context of the issue before the court, and the application of the same must be so limited. *Cohens v. Virginia*, 6 Wheat. 264, 398. For example, on *Toth's* own issue the recent Ninth Circuit Court of Appeals case of *Lee v. Madigan*, 248 F. 2d 783 (Dec. 7, 1957), upheld the power of a court-martial to try a civilian for conspiracy to commit murder, the offense having been committed while he was serving a court-martial sentence.

The Supreme Court, as indicated in *Burns v. Wilson*, 346 U. S. 137, regards the military system as a parallel system to the state courts and the federal constitutional courts. Justice Vinson speaking for the court stated:

“The military courts, like the state courts, have the same responsibilities as do the federal courts to protect a person from a violation of his constitutional rights. In military cases, it would be in disregard of the statutory scheme if the federal civil courts failed to take account of the prior proceedings,—of the fair determinations of the military tribunals after all military remedies have been exhausted. * * *

It should be noted that appellant served his sentence in the Federal Correctional Institution at Terminal Island, California. This is one unit of the federal prison system to which are sent all persons convicted in the federal court system. It is clear that as a matter of practice, as well as theory, the judgments of the courts-martial are accorded the same dignity and recognition as those of any other court under the federal system.

D. Court-Martial Organization and Practice Is Appropriately Judicial.

The argument that the court-martial is not a court in the true sense of the word because of its membership, or the method prescribed by law for the appointment of its members, fails completely in the revealing light of facts. The American jury has never been considered less than free because of the particular occupations of its members, or because the jury panel was constituted and called to service by officers of the court. The legislatively prescribed method for the appointment of members of the court-martial does not transform the organized court-martial into a subordinate agency of the appointing authority any more than the appointment of a federal judge by the President results in making that judge's court an arm of the executive branch of the government.

Once organized as a court-martial, it functions as any court in the state systems or federal constitutional system with painstaking rules and precautions designed to guarantee achievement of its goal to render justice. As stated by the Supreme Court in *Burns v. Wilson*, 346 U. S. 137, upon discussing the Uniform Code of Military Justice:

“Rigorous provisions guarantee a trial as free as possible from command influence, the right to prompt arraignment, the right to counsel of the accused's own

choosing, and the right to secure witnesses and prepare an adequate defense. The revised Articles and their successor—the new Code—also establish a hierarchy within the military establishment to review the convictions of courts-martial, to ferret out irregularities in the trial, and to enforce the procedural safeguards Congress determined to guarantee to those in the nation's armed services. And finally Congress has provided a special post-conviction remedy within the military establishment, apart from ordinary appellate review, whereby one convicted by a court-martial may attack collaterally the judgment under which he stands convicted.

“* * * Indeed, Congress has taken great care both to define the rights of those subject to military law, and provide a complete system of review within the military system to secure those rights.”

See also:

United States v. Clay, 1 U.S.C.M.A. 74, 81; 1 C.M.R. 74, 81.

E. The Necessary Recommendation Under the Statute Can Be Made.

The allegation is made that courts-martial are not equipped to make the recommendation to the Department of Justice that the alien be relieved from liability to deportation, as provided in 8 U.S.C. 1251(b), *supra*, therefore they cannot be courts whose convictions come within the purview of the statute.

The section provides that the recommendation may be made by the “court” sentencing the alien at the time of first imposing judgment, at the time of sentence, or within 30 days thereafter.

Two points should be discussed hereunder. First, it should be pointed out that the record shows no indication that appellant ever made application to anyone for a recommendation to the Department of Justice that he be relieved from liability of deportation. As the statute leaves the recommendation entirely to the discretion of the court, it cannot be known whether appellant's situation was such as to even merit such a recommendation.

Appellant, having failed and neglected to test the machinery he now analyzes, cannot now come before this court and seriously contend that said machinery is defective.

Secondly, the necessary recommendation under the statute can be made. Though no case is found wherein the question previously has arisen, nothing prevents an alien from requesting the recommendation from proper military authorities. In fact, the procedures afford many opportunities for an alien so situated to have his request heard by authority having the same powers over the case as possessed by the criminal court authorized to make the recommendation. As a practical matter, the alien may be afforded more opportunities and a longer period in which to have his request considered than he might in the civil courts. In the court-martial procedure the powers of the ordinary criminal court are split among the court-martial, the convening officer, and appellate authorities. Within the upper limits of severity imposed by the court-martial, the convening officer and appellate authorities have full sentencing power. *United States v. Atkins*, 8 U.S.C.M.A. 77, 23 C.M.R. 301; *United States v. Speller*, 8 U.S.C.M.A. 24 C.M.R. 173. This gives the alien various opportunities to procure the recommendation "at the time of first imposing judgment or passing sentence, or within thirty days thereafter" as provided by the statute.

In military law a judgment of conviction is not final in the sense that a criminal conviction is considered final when pronounced by the ordinary criminal court. Military procedure is designed to provide various checks on the initial verdict. Thus the conviction is final and sentence may be ordered into execution only when the appellate processes have been completed. The appellate procedures are but continuations of the initial trial.

Jackson v. Taylor, 353 U. S. 569;

Fowler v. Wilkinson, 353 U. S. 583;

UCMJ, Arts. 44, 71c;

U. S. v. Padilla and Jacobs, 1 U.S.C.M.A. 603,
5 C.M.R. 31.

The opportunities afforded the alien are well demonstrated by these details of court-martial procedure:

(1) After a finding of guilt, the court-martial reconvenes and hears evidence preparatory to passing upon sentence. Virtually any evidence and argument concerning mitigation or extenuation of the offense is heard before sentence is determined.

U. S. v. Strand, 6 U.S.C.M.A. 397, 20 C.M.R. 13;

U. S. v. Blau, 5 U.S.C.M.A. 232, 17 C.M.R. 232.

At that point, nothing prevented appellant from requesting the recommendation, or having it made part of a recommendation for clemency which might otherwise have been forthcoming from the court-martial in the manner authorized. MCM 1951, Par. 77. See also *U. S. v. Doherty*, 5 U.S.C.M.A. 287, 17 C.M.R. 287.

(2) After announcement of sentence by the court-martial itself in all general court-martial cases (appellant having undergone general court-martial) the sentence must

be reviewed and acted upon by the officer who convened the court-martial. *UCMJ*, Articles 61, 64 and 65. He must cause an impartial written opinion and report to be made. The report is similar to the pre-sentence or probation report made prior to sentence in the United States District Courts. *U. S. v. Coulter*, 3 U.S.C.M.A. 657, 14 C.M.R. 75. At this point again, appellant could have submitted whatever he desired for consideration of the convening officer. *U. S. v. Lanford*, 6 U.S.C.M.A. 371, 20 C.M.R. 87. After considering the above report, the convening officer promulgates the results of trial and the sentence. He must approve or disapprove the findings and sentence, and can be said to have almost complete sentencing power within the upper limits of severity of the sentence determined by the Court-martial. *U. S. v. Speller, supra*.

(3) All general court-martial cases resulting in serious punishments must be further reviewed by a Board of Review in the Office of the Judge Advocate General. *UCMJ*, Arts 66, 71(c). Once again, appellant had ample opportunity to address either the Judge Advocate General or the Board of Review, or both on the matter of deportation and procurance of the appropriate recommendation. See: 32 CFR 61.9(f), last sentence.

(4) Upon affirmance by the Board of Review of the conviction and sentence as both legal and appropriate, if no recommendation were forthcoming from the Judge Advocate General, appellant might have appealed to the Secretary of the Army on the matter of deportation. The Secretary exercises broad clemency powers over court-martial convictions. *UCMJ*, Art. 74.

(5) The conviction is made "final" when the final order is made directing the execution of the sentence, *UCMJ*,

Arts. 66(e), 71(e); *MCM*, paragraphs 90b(2), 100b, 107; after leave to appeal to the Court of Military Appeals expires. *UCMJ*, Arts. 58, 67(b)(3).

It should be observed that there is no difference in these procedures whether there is a plea of guilty or not guilty, although convictions on pleas of guilty are amenable to quicker disposition.

If it be assumed that the 30-day statutory period for the recommendation begins to run after the conviction is legally "final," then it would run from the final order directing the execution of sentence. Although the court-martial is an *ad hoc* body, the convening officer and appellate authorities are continuing institutions exercising powers ordinarily possessed by the usual criminal court. It is thus apparent that the proper recommendation might be made at any step in the court-martial procedure beginning from the point of the first verdict of the court-martial, up to and subsequent to the order directing the execution of the sentence.

F. There Is No Basis for Contention That Appellant's Court-martial Convictions Might Not Have Been Convictions in California.

In support of his major premise, appellant alleges that if he had been tried in the State of California instead of by court-martial, he might not have had any criminal proceedings against his record, and consequently there would be no basis for deportation. This, of course, is at best pure speculation, and even if assumed true, would not be persuasive as to his premise.

However, there is no need to delve further into its ramifications, as the allegation itself is not correct. Appellant was nineteen years old when he committed the offenses

of which he was convicted. The juvenile court has original jurisdiction up to the age of eighteen years of age only, and even as to juveniles under eighteen years, the juvenile court need not accept jurisdiction. Hypothetically, any juvenile in the 19 to 21 age group may be certified to the juvenile court, and the juvenile court may accept jurisdiction. However, by established practice and precedent, this is done only in rare cases of juveniles who have just turned eighteen, and who are inordinately immature and inexperienced. Furthermore, it is limited to offenses falling within the lesser areas of crime wherein no particular criminal intent is demonstrated. Juveniles involved in crimes of force and violence as was the appellant remain under regular criminal divisions.

II.

Appellant Has Been Convicted of Two Offenses Involving Moral Turpitude.

Appellant has been convicted of two offenses under the Uniform Code of Military Justice. The first offense was a violation of Article 121, entitled Larceny and Wrongful Appropriation. The second offense was a violation of Article 122, entitled Robbery.

It should be observed that Article 121, *supra*, includes two separate offenses. The second offense is omitted in appellant's quotation of the Article; thus the Article in its entirety is set forth as follows:

“§ 715. *Larceny and wrongful appropriation (article 121)*

“(a) Any person subject to this chapter who wrongfully takes, obtains, or withholds, by any means

whatever, from the possession of the true owner or of any other person any money, personal property, or article of value of any kind—

“(1) with intent permanently to deprive or defraud another person of the use and benefit of property or to appropriate the same to his own use or the use of any person other than the true owner, steals such property and is guilty of larceny; or

“(2) with intent temporarily to deprive or defraud another person of the use and benefit of property or to appropriate the same to his own use or the use of any person other than the true owner is guilty of wrongful appropriation.

“(b) Any person found guilty of larceny or wrongful appropriation shall be punished as a court-martial may direct.”

The legislative history, the Manual for Courts-Martial prescribed under the UCMJ, and the case decisions in the appellate courts of the military system make the meaning of the provisions in question absolutely clear.

The elements of the two offenses “Larceny” and “Wrongful Appropriation” contained in Article 121 are identical except for the degree of intent required to be proved. Larceny requires the criminal acts to be done with intent to permanently deprive another of property, while Wrongful Appropriation requires only the intent to temporarily deprive another of the property. The more serious offense statutorily termed “larceny” and defined succinctly as the “taking, obtaining, or withholding” of property, etc., with the requisite intent, is merely the codification of the three offenses known at common law as larceny, obtaining by false pretenses, and embezzlement. (Until the enactment of the UCMJ, military law was still plagued with

those ancient technicalities.) Under the UCMJ pleading the word “steal” covers all forms of larceny. Likewise the words “wrongfully appropriate” covers all forms of the lesser offense of Wrongful Appropriation.

U. S. v. Norris, 2 U.S.C.M.A. 236, 8 C.M.R. 36;

U. S. v. Aldridge, 2 U.S.C.M.A. 330, 8 C.M.R. 130;

U. S. v. Buck, 3 U.S.C.M.A. 341, 12 C.M.R. 97;

U. S. v. May, 3 U.S.C.M.A. 703, 14 C.M.R. 121;

U. S. v. Geppert, 7 U.S.C.M.A. 741, 22 C.M.R. 205;

U. S. v. McFarland, 8 U.S.C.M.A. 42, 23 C.M.R. 466;

MCM, paragraph 200, pages 356-364;

Hearings, House Comm. on Armed Services, 81st Cong., 1st Session, on H.R. 2498, page 1232.

There is a great difference in the maximum penalty between “Larceny” and “Wrongful Appropriation.” Larceny of property of over \$50.00 in value carries a maximum term of confinement of five years, while wrongful appropriation of the same property (other than a motor vehicle) has a maximum of only six months. *MCM, Table of Maximum Punishments*, page 223.

Even in the lesser offense of Wrongful Appropriation, the element of criminal intent is required, and the element of fraud permeates the whole offense. *U. S. v. Geppert, supra*.

Clearly, appellant’s argument that an innocent act devoid of criminal intent could be punishable under Article 121 is without merit.

The other offense of Appellant was a violation of UCMJ Article 122, titled "Robbery." The offense under this article is the same as the crime of robbery known to all other criminal jurisdictions.

MCM, paragraph 201, pages 363-364;

U. S. v. Rios, 4 U.S.C.M.A. 203, 15 C.M.R. 203;

U. S. v. Cunningham, 6 U.S.C.M.A. 106, 19 C.M.R. 232;

U. S. v. Butler (Navy BR), 16 C.M.R. 419;

U. S. v. Tamaro (Air Force BR), 16 C.M.R. 610.

The maximum term of confinement imposable for a violation of Article 122 is ten years. *MCM, Table of Maximum Punishments*, page 223.

The violation of either section thus involves moral turpitude. The Supreme Court has determined that offenses containing an inherent fraud element involve moral turpitude. *Jordon v. de George*, 341 U. S. 223 (1951).

It has also been held that theft, except in unusual circumstances, is a crime involving moral turpitude. *U. S. ex rel Rizzo v. Kenney*, 50 F. 2d 418.

Moral turpitude is defined as an act of baseness, villainess, or depravity in private and social duties owing to fellowmen, or society in general, contrary to accepted moral standards and customary rules.

Mg Sui Wing v. U. S., 46 F. 2d 755, 756;

U. S. ex rel. Manzella v. Zimmerman, 71 F. Supp. 537.

It is clear that stealing a pistol worth more than \$50.00, the property of the United States, and robbing an individual of his automobile by force and violence, is contrary to accepted moral standards.

A similar court-martial conviction has been given full effect under New York law.

Florance v. Donovan, 126 N. Y. S. 2d 642, *affd.*
121 N. E. 2d 535.

The Immigration Act of 1952 makes no changes in the law in regard to "conviction" as provided by the Immigration Act of 1917 as Amended. However, the 1952 Act does eliminate any provision that the conviction must occur "in this country." This change validates convictions of military crimes in Germany as here, and would appear to have been instituted for that very purpose of covering military crimes in any locality wherein the armed forces are located.

Conclusion.

As the privilege of living in the United States is much sought after, deportation is generally viewed with appropriate seriousness. However, opportunity to enter this country for permanent residence has always been considered a privilege, and Congress has seen fit to restrict the blessing to those persons who will establish themselves as good citizens. As an implementation of this philosophy, the deportation provisions in question here were set forth by statute. It is not unreasonable to expect appellant to live as a law-abiding citizen the same as any other person.

He cannot now avoid the consequences of his reprehensible acts by taking refuge in technicalities.

We therefore submit that the judgment of the District Court upholding the validity of the Order of Deportation should be affirmed.

Respectfully submitted,

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No. 15,740

IN THE

United States Court of Appeals
For the Ninth Circuit

JACQUES ARTHUR GUBBELS,

Appellant,

VS.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los Angeles, California,

Appellee.

BRIEF FOR APPELLANT.

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No. 15,740

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JACQUES ARTHUR GUBBELS,
Appellant,

vs.

ALBERT DEL GUERCIO, as District Director,
Immigration and Naturalization Service, Los Angeles, California,
Appellee.

BRIEF FOR APPELLANT.

JURISDICTIONAL STATEMENT.

This appeal is from a judgment (T. 17-21) of the United States District Court for the Southern District of California, Central Division, in an action for judicial review of an order of deportation. The action was brought pursuant to 28 U.S.C. 2201 and 5 U.S.C. 1009 (T. 3), and jurisdiction of the court below is predicated upon those sections and upon 8 U.S.C. 1329. Jurisdiction to review the judgment of the court below is conferred upon this Court by 28 U.S.C. 1291.

STATEMENT OF THE CASE.

The facts are not in dispute. Appellant is twenty-two years old, a native of Belgium and a citizen of the Netherlands. He arrived in the United States with his parents¹ on February 3, 1948, when he was twelve years of age, and was admitted for permanent residence. At the age of seventeen he enlisted in the United States Army. On September 13, 1954, while serving in Germany, he pleaded guilty before a court-martial to charges of violating Articles 121 and 122 of the Uniform Code of Military Justice (50 U.S.C., former Sections 715, 716), i.e., that he stole a pistol which was the property of the United States and that he stole an automobile, both being of the value of more than \$50.00. The violations occurred in Germany on March 16, 1954 and on August 2, 1954, respectively. Appellant was then nineteen years of age. The court-martial ordered that he be confined at hard labor for five years and that he be dishonorably discharged. He was released from said confinement on parole on September 29, 1956.

Appellant's deportation has been ordered under the Immigration and Nationality Act of 1952 on the ground that he is one who "after entry was convicted of two crimes involving moral turpitude" (8 U.S.C. 1251(a)(4)).

The District Court has upheld the validity of the deportation order, and its opinion (T. 12-17) is reported at 152 F.S. 277.

¹The parents have since become naturalized citizens.

The questions involved in this appeal are:

1. Does the judgment of the court-martial bring appellant within the purview of the deportation statute (8 U.S.C.A. 1251(a)(4), *supra*) ?
2. Has appellant been convicted of two crimes involving moral turpitude within the meaning of that subsection ?

SPECIFICATION OF ERRORS.

The errors relied upon by appellant are:

1. That the District Court erred in holding that the judgment of the court-martial constitutes conviction of crimes within the meaning of 8 U.S.C. 1251(a)(4) ;
2. That the District Court erred in holding that appellant has been convicted of two crimes involving moral turpitude within the meaning of that subsection.

ARGUMENT.

I.

**THE JUDGMENT OF A COURT-MARTIAL DOES NOT CONSTITUTE
CONVICTION OF CRIME WITHIN THE MEANING OF THE
DEPORTATION STATUTE (8 U.S.C. 1251(a)(4)).**

The question whether the deportation provisions relative to persons convicted of crimes involving moral turpitude are applicable to judgments of a military tribunal has not heretofore been judicially

decided in any reported case. The question was mentioned in passing but was left undecided in *U. S. ex rel. Parenti v. Martineau*, 50 F.2d 902.

The administrative holdings on this question over the years have not been consistent. For a number of years the executive department held that judgments in court-martial proceedings did not constitute convictions of crime within the meaning of the deportation statute. Subsequently, the Board of Immigration Appeals adopted the contrary view. Before summarizing these conflicting administrative opinions, we refer briefly to certain basic considerations.

First, the deportation statute itself (8 U.S.C. 1251); the pertinent provisions of the statute are as follows:

“Sec. 241. *Deportable aliens—General classes*

(a) Any alien in the United States (including an alien crewman) shall, upon the order of the Attorney General, be deported who— * * *

(4) is convicted of a crime involving moral turpitude committed within five years after entry and either sentenced to confinement or confined therefor in a prison or corrective institution, for a year or more, or who at any time after entry is convicted of two crimes involving moral turpitude, not arising out of a single scheme of criminal misconduct, regardless of whether confined therefor and regardless of whether the convictions were in a single trial;

* * * * *

(b) The provisions of subsection (a)(4) of this section respecting the deportation of an alien convicted of a crime or crimes *shall not apply*
* * *

(2) *if the court sentencing such alien for such crime shall make, at the time of first imposing judgment or passing sentence, or within thirty days thereafter, a recommendation to the Attorney General that such alien not be deported, due notice having been given prior to making such recommendation to representatives of the interested State, the Service, and prosecution authorities, who shall be granted an opportunity to make representations in the matter.*" (Italics added.)

Secondly, the Supreme Court has held that the rule of construction to be applied in determining the effect of these deportation provisions is "that which is required by the narrowest of several possible meanings of the words used" (*Fong Haw Tan v. Phelan*, 333 U.S. 6, 68 S.Ct. 374, 92 L.Ed. 433). In that case the Supreme Court was considering the corresponding provision of the prior deportation statute (8 U.S.C. 155) which required deportation of aliens "sentenced more than once" to imprisonment for a year or more because of conviction in this country of crimes involving moral turpitude. The provision involved in the case at bar is derived from that same clause but makes deportation depend upon convictions alone rather than upon the length of sentences imposed. The language of the Supreme Court is most significant:

"We resolve the doubts in favor of that construction because deportation is a drastic measure and at times the equivalent of banishment or exile. *Delgadillo v. Carmichael*, 332 U.S. 388, 68

S.Ct. 10. It is the forfeiture for misconduct of a residence in this country. Such a forfeiture is a penalty. To construe this statutory provision less generously to the alien might find support in logic. But since the stakes are considerable for the individual, we will not assume that Congress meant to trench on his freedom beyond that *which is required by the narrowest of several possible meanings of the words used.*" (Italics added.)

There are basic reasons why Section 1251(a)(4), *supra*, should not be construed as embracing military offenders within its operation on the basis of judgments of a court-martial. In the first place, the specific exception in subsection (b) that the deportation provision *shall not apply* if "the court" at the time of judgment or "within thirty days thereafter" makes a recommendation that the alien not be deported cannot have reference to courts-martial which, as we shall show, are not courts but agencies of the executive department of the Government, which are created as a mere incident to the military function to provide a summary means of maintaining military discipline and control, which are called into existence for a specific purpose to perform a particular duty, and which are dissolved when that purpose has been accomplished. Subsection (b), *supra*, plainly contemplates judicial proceedings in which the parties, after judgment, may, by formal representations to the court, invoke the court's statutory authority with regard to making recommendation that the convicted person be not deported. This is an authority frequently exercised by the courts (e.g. *Ex parte Robles-*

Rubio, 119 F.S. 610), and certainly courts are especially fitted to make such a determination upon consideration of the alien's entire background, whereas, such a determination is wholly inapposite to military tribunals by their very nature, purpose and function.

As subdivision (b) of the section is a specific excepting clause to the operation of subsection (a)(4), it must be read in conjunction with that subsection, and as a part thereof. Certainly it would strain the bounds of reason and logic to say that Congress, in speaking of a court making a recommendation at the time of judgment or within thirty days thereafter, upon notice to the Immigration and Naturalization Service and the prosecution authorities, with opportunity for them to be heard in the matter, had in contemplation such matters as proceedings before military tribunals convened (frequently in foreign lands) to consider infractions on the part of a member of the armed forces. It is this consideration which led to the administrative view originally that the similar provisions of the prior deportation act did not apply to judgments of military tribunals.

The earliest published administrative decision on this point is

Matter of P—, Vol. I, Admin. Dec. under Immigration and Nationality Laws, page 3.

That case involved conviction by court-martial in a foreign army of stealing money from a fellow soldier. Deportation had been sought under that portion of the former deportation statute (8 U.S.C. 155) which required deportation of any alien "who was convicted,

or who admits the commission, prior to entry, of a felony or other crime or misdemeanor involving moral turpitude.” With regard to the charge of *conviction*, the Board of Immigration Appeals said:

“In the consideration of this case on April 18, 1940, on the basis of an opinion of the Solicitor of Labor (55871/359), which had been adopted by the Immigration and Naturalization Service, it was concluded that the respondent was not subject to deportation because he had been convicted of a crime for the reason that a conviction by a court-martial was not considered a ‘conviction’ under the immigration laws.”

The Board concluded, however, that although the alien was not deportable as one who had been “*convicted*,” he was within the other portion of the clause there involved relative to one who *admitted* the commission of theft prior to entry. Subsequently, the Attorney General *reversed* the Board’s decision and cancelled the deportation proceedings entirely, stating that: “It is an admission that respondent took the money, but the record is bare of evidence indicating that he took it with a criminal intent, or that respondent’s conduct in the army would have constituted a civil crime under Italian law” (Id. page 39).

The effect of the decision of the Attorney General in that case, therefore, was to accept the view that conviction by a court-martial did not bring the alien within the terms of the deportation statute, and further to hold that he could not be deported as one who *admitted* the commission of a crime.

Some two years after the decision in the case just cited, the Board of Immigration Appeals decided another case involving conviction by court-martial of theft in Canada (*Matter of W—*, Vol. I, Admin. Dec. under Immigration and Nationality Laws, page 485), without mentioning the decision of the Attorney General nor its own decision in *Matter of P—*, supra. The Board did, however, mention the opinion handed down by the Solicitor of Labor on December 14, 1934, which held that court-martial convictions were not within the purview of the deportation statute. In that regard the Board said:

“He asserted that the provisions of section 19 excepting from the consequences of a conviction an alien who had been pardoned or an alien as to whom the court or judge recommended against deportation could not be reconciled with the notion that the judgments of military tribunals were within the purview of the section; and finally, that in view of the principle that a penal statute should be strictly construed, the soundest construction of the statute should omit from its operation determinations of guilt not made under the criminal law administered by the civil authorities. Although it may be conceded, as the Solicitor maintains, that the issue is not free from difficulty, we think that consideration of the nature of court-martial proceedings leads to the conclusion that a conviction by a court-martial should be accorded the same dignity and effect as a conviction by an ordinary civil court.”

We would point out that here the Board went off on a tangent. The question is not one of collateral attack

upon proceedings of a court-martial. The question is simply and solely whether the *deportation statute* in its reference to convictions and to courts is to be interpreted as comprehending within its scope the proceedings of a military tribunal, and in considering and determining that question, all the language of the deportation statute must be considered, and must be given the interpretation "which is required by the narrowest of several possible meanings of the words used" (*Fong Haw Tan v. Phelan*, supra).

Does the language of the deportation statute above quoted in "the narrowest of several possible meanings of the words used" permit of the interpretation that proceedings of military tribunals were in contemplation? We think not.

"While courts-martial may and do discharge judicial functions and are therefore in a certain sense courts, they are not a part of the judiciary department of the Government; and are more properly classed as an executive agency belonging to the executive branch of the Government." (18 *Ruling Case Law*, 1061.)

"A court martial is a military or naval tribunal which has jurisdiction of offenses against the law of the service, military or naval, in which the offender is engaged. Courts-martial, while resembling the civil courts in some respects, are yet entirely distinct in their nature from the civil tribunals; the power vested in the military courts is not a part of the judicial power of the United States within the meaning of the Constitution, and such courts are not included in the judicial department of the government." (Vol. 6, *Corpus Juris Secundum*, 440.)

In this connection, the language of the Supreme Court of the United States in the recent case of
U. S. ex rel. Toth v. Quarles, 350 U.S. 11, 76
 S.Ct. 1, 100 L.Ed. 8.

is particularly enlightening. In that case the court pointed out that court-martial jurisdiction "sprang from the belief that within the military ranks there is need for a prompt, ready-at-hand means of compelling obedience and order." The Supreme Court also said:

"We find nothing in the history or constitutional treatment of military tribunals which entitles them to rank along with Article III courts as adjudicators of the guilt or innocence of people charged with offenses for which they can be deprived of their life, liberty or property."

* * * * *

"Unlike courts, it is the primary business of armies and navies to fight or be ready to fight wars should the occasion arise. But trial of soldiers to maintain discipline is merely incidental to an army's primary fighting function * * *. And conceding to military personnel that high degree of honesty and sense of justice which nearly all of them undoubtedly have, it still remains true that military tribunals have not been and probably never can be constituted in such way that they can have the same kind of qualifications that the Constitution has deemed essential to fair trials of civilians in Federal courts."

Of course within their own sphere, proceedings of courts-martial are as unassailable as judgments of courts, but they are not "courts" as that term is used

in its usual sense, they are not part of the judicial department of the Government, and are "more properly classed as an executive agency belonging to the executive branch of the Government" (18 *Ruling Case Law*, 1061, *supra*). They are special agencies brought into being to meet the exigencies of the problem of military discipline; jurisdiction of a court-martial is limited and special, it being called into existence for a temporary and special purpose and to perform a special duty, and when the object of its creation has been accomplished, it ceases to exist (*United States v. McDonald*, 265 F. 754, 760, Appeal Dismissed, 256 U.S. 705, 41 S.Ct. 535, 65 L.Ed. 1180).

Moreover, the nature of courts-martial is not such as to enable them to make the judicial determination referred to in subsection (b) of the statute, whereby a defendant, at the time of, or after, judgment, is relieved from liability to deportation upon recommendation of the trial court made in the manner and within the time prescribed in the statute. To bring courts-martial within the scope of the statute, it would be necessary both to stretch words and to disregard substance.

To construe the judgments of courts-martial to be within the purview of Section 1251(a)(4) and 1251 (b), *supra*, would give rise to many incongruities. In the first place, the end result would be that aliens in the military service of the United States would be in a far worse position so far as the deportation provisions are concerned than would be the alien civilian. Certainly an alien soldier serving the United States on foreign soil who may be charged before a court-

martial, as was appellant here, would as a practical matter be deprived of the possible relief from deportation which is prescribed by subdivision (b) of the section, *supra*, since the military tribunal obviously would not and could not remain in being to consider representations of the immigration authorities in the United States as to whether or not a recommendation should be made that the soldier should not be deported. Being called into being to consider specified charges involving a person within the military jurisdiction, the function of the tribunal ceases when it has made its findings and pronounced its judgment. Unlike a court, it is not a body having continuous existence enabling it to consider and act upon supplemental proceedings of the character contemplated by Section 1251(b), *supra*.

Secondly, a minor alien serving in the United States armed forces and tried for an offense or infraction by a court-martial would be at a further disadvantage in comparison with the alien civilian accused in the civil courts of the same sort of transgression. For example, had appellant here been tried on the same charges in the State of California, which was the place of his residence at the time of his enlistment in the United States Army, the court might have suspended proceedings and certified the matter to the juvenile court, as permitted with respect to minors between the ages of eighteen and twenty-one (California Welfare and Institutions Code, Section 833.5), and if the juvenile court did not find that the minor was an unfit person to be treated as a juvenile, then all proceedings in the matter "shall not constitute

criminal proceedings of any nature against such minor person" (Section 833.5, *supra*), and of course would consequently not furnish any basis for deportation. This is another cogent reason why court-martial proceedings should not be regarded as within the purview of the deportation statute, in the absence of express words showing that proceedings of such tribunals were meant to be included.

Again, under military law certain conduct might be regarded as a crime which in civilian life would amount to no more than a civil tort. This particular matter will be discussed in greater detail in the succeeding subdivision of this brief.

To apply the deportation statute to military offenders would bring about a number of other incongruities and anomalies. It was consistently held by the administrative authorities that under the previous deportation statute (8 U.S.C. 155, *supra*), an alien who was convicted of crimes involving moral turpitude while serving in the United States armed forces *in foreign territory* was not subject to deportation because that statute covered only conviction "in this country." It was therefore concluded that prior to the enactment of the present statute (8 U.S.C. 1251, *supra*), convictions of United States army personnel by court-martial in Germany did not render the individual deportable.

Matter of J—, Vol. III, Admin. Dec. under Immigration and Nationality Laws, 536;

Matter of P—, Vol. VI, Admin. Dec. under Immigration and Nationality Laws, 481.

Under that line of administrative decisions, an alien serving in the armed forces of the United States who was tried by court-martial in this country would be deportable but an alien soldier tried by court-martial for the same offense while serving in the armed forces of the United States abroad would not be deportable (up to the passage of the present Immigration and Naturalization Act of 1952). The anomaly is intensified when it is considered that since the passage of the Act of 1952, if the reasoning pursued by the Board of Immigration Appeals in the case at bar be correct, the two alien soldiers who were held in the decisions last cited not to be subject to deportation under the previous statute, would have now become subject to deportation by reason of the enactment of the 1952 statute, which omits the words "in this country" (Section 1251(a)(4), *supra*), and which is retrospective (Section 1251(d)).

It is therefore settled that prior to the 1952 statute aliens convicted by court-martial while serving in the United States armed forces outside the United States were not subject to deportation on account of such convictions. If this situation has been changed by the 1952 Act, it can only be because of the omission of the words "in this country" from the statutory provisions relative to convicted aliens. We submit that no such significance can reasonably be attached to the mere omission of these words. It seems reasonable and probable that in the 1952 Act, the words "in this country" were omitted as superfluous since under the all-embracing definition of the term "entry" (8

U.S.C. Section 1101(a)(13)) contained in that statute, the words "after entry" in Section 1251(a)(4), *supra*, would necessarily imply that the convictions occur in the United States.

There is a further reason in support of the proposition that judgments of courts-martial are not to be considered as convictions for purposes of deportation. The discipline of the armed forces presents problems of great difficulty, and necessarily the military power and military tribunals are given great latitude in connection with the prosecution and punishment of offenders who are serving in the military forces. What might be punishable in those circumstances as a theft, for example, or as "stealing," might in fact, if it occurred in civil life, amount only to a mere civil tort, such as conversion of property without criminal intent. We think it is this which the Attorney General had in mind in stating in *Matter of P—*, *supra*, that although the alien had been charged with theft before an Italian court-martial and admitted that he did steal the money involved, there was no showing of "a criminal intent, or that respondent's conduct in the army would have constituted a civil crime under Italian law." In short, because of the very nature of the problem of military discipline, a soldier might be charged with and punished for the crime of theft in a court-martial proceeding where if the same act were committed in civil life it would not have amounted to a crime.

All these considerations are incompatible with the concept of a Congressional intent to include military

offenders convicted by court-martial within the purview of the deportation provisions under discussion. The question is not whether Congress could have included such cases within the purview of the statute but whether Congress did so. In determining that question, the narrowest meaning of the words used must be adopted. To interpret those words as including court-martial proceedings would place alien members of our armed forces in a much more disadvantageous position with respect to liability to deportation than that of alien civilians under similar circumstances. Only the clearest possible expression of the Congress should be construed as bringing about such a result.

Statutes making reference to convictions and offenses generally are not always interpreted as including proceedings before courts-martial. We would point out that the United States Supreme Court held in *Kurtz v. Moffitt*, 115 U.S. 487, 6 S.Ct. 148, 29 L.Ed. 458, that in the absence of express statute of Congress, neither the common law rule nor state statutes (California Penal Code, 836, 837, 849) relating to arrests of offenders without warrant were to be interpreted as applying to offenders against military law, punishable by court-martial. So also in *Getz v. Getz*, 332 Ill. App. 364, 75 N.E. (2d) 530, it was held that in view of the peculiarities of court-martial proceedings it could not be said that the Legislature, in enacting that conviction of a felony or other infamous crime constituted ground for divorce, had in contemplation anything except convictions which are the result of crimi-

nal proceedings under the usual procedures followed in the civil courts.

In its opinion in the case at bar, the District Court concluded that in the deportation statute Congress had not expressed any distinction between convictions in courts and convictions before military tribunals. But in the *Fong Haw Tan* case, *supra*, the Supreme Court considered a similar contention that the expression "sentenced more than once" made no distinction between two sentences in a single judgment and sentences in two separate criminal proceedings, and held that the language must be given its narrowest meaning, viz., that the alien after being once convicted and sentenced again commits an offense which gives rise to a second sentence. Furthermore, in the present statute the language of subsection 1251(b) does not lend itself to the construction that military tribunals were in contemplation. Consequently there is much more basis here for the narrower construction than there was in the *Fong Haw Tan* case, *supra*. Moreover, such considerations as the finality of judgments of courts-martial or their effect under so-called "double jeopardy" statutes are not germane to the question of statutory interpretation which is presented in the case at bar.

For all the foregoing reasons, we submit that the judgment of the court-martial in the case at bar does not constitute convictions of crime within the meaning of the deportation statute.

II.

APPELLANT HAS NOT BEEN CONVICTED OF TWO CRIMES INVOLVING MORAL TURPITUDE WITHIN THE MEANING OF THE DEPORTATION STATUTE.

One of the offenses which is the basis of the order of deportation was violation of Article 121 of the Uniform Code of Military Justice (50 U.S.C., former Section 715) in that appellant did "steal" a pistol which was the property of the United States. The pertinent portion of Article 121, *supra*, provides as follows:

"Any person subject to this chapter who wrongfully takes, obtains or *withholds*, by any means whatever, from the possession of the true owner *or any other person* any money, personal property, or article of value of any kind—(1) with intent permanently to deprive or defraud *another person* of the use and benefit of property or to appropriate the same to his own use or the use of any person other than the true owner, steals such property and is guilty of larceny * * *." (Italics added.)

It will be observed that this Article, in its terms, is much broader than the usual definitions of larceny in ordinary criminal proceedings. It is not necessary that the offender withhold property from its true owner; it is enough if he withholds it from any other person with intent to deprive such other person of its use. It is quite conceivable that a soldier could be convicted under this particular Article for failing to turn in at the prescribed time an article of government property which had been issued to him for his

temporary use, or for taking for his own military use an article of equipment which had been issued to some other soldier. We might use one illustration which is common in military life, that should a soldier lose a piece of his own equipment and fear to face a reprimand for such loss, it is not uncommon to appropriate in its place a piece of equipment which had actually been issued to some other member of the company. In such a situation, there would obviously be no criminal intent or moral turpitude in the usual sense. Yet such an offender could undoubtedly be charged and punished under Article 121, *supra*.

It is settled that, unless the offense of which an alien is convicted is one which by its definition *necessarily* involves moral turpitude, the alien cannot be deported because in the particular instance his conduct might be regarded as immoral (*U. S. ex rel. Robinson v. Day* (C.A.2) 51 F.2d 1022. In the case at bar it would seem to be plain from the language of Article 121, *supra*, that appellant could have been convicted of violating that Article even on the basis of conduct which might have fallen far short of an act necessarily involving moral turpitude. In other words, the so-called "stealing" under that Article could have been simply a wrongful withholding which in civil life would amount to no more than a non-criminal conviction, or at least an infraction lacking in the elements of baseness and depravity necessarily involved in the concept of moral turpitude.

We submit, therefore, that under any view of the case, appellant has not been convicted of two crimes

involving moral turpitude within the meaning of the deportation statute.

CONCLUSION.

The seriousness of the consequences of deportation in this case are evident. The respondent came to the United States when he was a small boy and voluntarily joined the armed forces of the United States at the tender age of seventeen years. His parents are citizens of the United States. It is true that he has committed violations of the military laws, as set forth in the Uniform Code of Military Justice, and that he has undergone his punishment therefor and is still on parole. On the other hand, it does not necessarily follow that the conduct of which he was guilty, if committed in a civilian capacity, would be classified as the same sort of offense. It is in this background that we believe this case must be viewed. For the reasons hereinabove discussed, we submit that the deportation statute cannot reasonably be interpreted as comprehending within its terms convictions by a court-martial under the circumstances here presented. Prior judicial authority for such an interpretation is lacking, and we think the better administrative view in the past has been to the contrary, as hereinabove set forth. Finally, the Supreme Court of the United States has declared that the rule of construction must be the narrowest of several possible meanings of the words used. We believe, therefore, in the light of this rule of construction, and the other considerations

hereinabove set forth, that there is no escape from the conclusion that the court-martial convictions in this case are not within the purview of the provisions contained in 8 U.S.C., Section 1251 with reference to the deportation of persons convicted of crimes involving moral turpitude.

We respectfully submit that the judgment of the District Court should be reversed.

Dated, San Francisco, California,
January 15, 1958.

PHELAN & SIMMONS,
ARTHUR J. PHELAN,
MILTON T. SIMMONS,
MARSHALL E. KIDDER,
Attorneys for Appellant.

(Appendix Follows.)

Appendix.

Appendix

EXHIBIT INTRODUCED INTO EVIDENCE.

Transcript Pages 17-18—Certified copy of Immigration and Naturalization proceedings received into evidence as defendant's Exhibit A for review by the court.

No. 15741

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IRWIN ARAN d/b/a AUTO NURSE MANUFACTURING COM-
PANY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Appeal From the United States District Court for the
Southern District of California, Central Division.

OPENING BRIEF OF APPELLANT.

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FILED

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PAUL J. GIVENS

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No. 15741

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IRWIN ARAN d/b/a AUTO NURSE MANUFACTURING COMPANY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Appeal From the United States District Court for the Southern District of California, Central Division.

OPENING BRIEF OF APPELLANT.

This action arose in the United States District Court for the Southern District of California under the jurisdiction granted by Title 28, United States Code, Section 1346(a)1.

Jurisdiction.

Appellant sought a refund of Manufacturers Excise Taxes erroneously paid. Matter was heard and testimony and documents were introduced in evidence. On April 9, 1957, the Court made an order for findings of fact, conclusions of law and judgment for the respondent and on

May 17, 1957, judgment was entered for respondent, in the docket. This order and judgment are final and appealable.

Jurisdiction is conferred upon this Court by Title 28, United States Code, Section 1291. Appellant filed his Notice of Appeal on July 1, 1957.

Issues Presented.

(1) WHETHER THE LOWER COURT ERRED IN DETERMINING THAT BABY BOTTLE WARMERS AS MANUFACTURED AND SOLD BY APPELLANT ARE AUTOMOBILE PARTS OR ACCESSORIES WITHIN THE LANGUAGE OF SECTION 3403(c) OF THE 1939 INTERNAL REVENUE CODE AND ITS PRESENT COUNTERPART SECTION 4061(b) OF 1954 INTERNAL REVENUE CODE?

(2) WHETHER TREASURY REGULATION 46,316.55(c) AS AMENDED T. D. 5099 1941-2 CUM. BULL. 267 IS AN UNREASONABLE INTERPRETATION OF THE STATUTE UPON WHICH IT IS BASED, AND AS SUCH INAPPLICABLE TO IMPOSE A TAX UPON BABY BOTTLE WARMERS, USABLE IN AUTOMOBILES?

(3) WHETHER THE COURT ERRED IN USING THE PRIMARY ADAPTABILITY TEST IN DETERMINING WHETHER BABY BOTTLE WARMERS ARE AUTOMOBILE PARTS OR ACCESSORIES AS INCLUDED WITHIN THE LANGUAGE OF SECTION 3403(c) OF THE 1939 INTERNAL REVENUE CODE NOW SECTION 4061(b) OF THE 1954 INTERNAL REVENUE CODE?

(4) WHETHER THE COURT ERRED IN FINDING THAT APPELLANTS BABY BOTTLE WARMERS ARE NOT EQUALLY ADAPTABLE TO OTHER USES AND HENCE NOT SUBJECT TO TAX UNDER SECTION 3403(c) OF THE 1939 INTERNAL REVENUE CODE NOW 4061(b) OF THE 1954 INTERNAL REVENUE CODE?

(5) WHETHER THE JUDGMENT IS CONTRARY, IN PART, TO THE LAW AND EVIDENCE?

Statement of Facts.

Appellant is the manufacturer of baby bottle warmers fitted with a cord and plug connection which may be inserted into the cigarette lighter socket found in automobiles and motor vehicles equipped with such lighters.

These baby bottle warmers are, among other things, designed to warm a baby's bottle in an automobile. The Treasury Department had for many years taxed appellant's baby bottle warmers as an automobile part or accessory under Section 3403(c) of the 1939 Internal Revenue Code and a Treasury regulation commonly referred to as T. R. 46.316.55(c) as Amended T. D. 5099, 1941-2 Cum. Bull. 267.

The Treasury Department is now taxing appellant's baby bottle warmers under Section 4061(b) of the 1954 Internal Revenue Code which is the present counterpart of Section 3403(c).

Neither of these sections expressly or impliedly include baby bottle warmers as parts or accessories of automobiles, but the Treasury regulation aforesaid makes any item primarily adaptable for use in an automobile. Taxable as an automobile part or accessory, whether essential to the operation thereof or not.

Appellant during the period of May 31, 1949, through November 17, 1954, paid to the respondent the sum of \$8,208.62 as payments of manufacturers' excise tax under Section 3403(c) of the 1939 Internal Revenue Code, now Section 4061(b) of the 1954 Internal Revenue Code.

On February 4, 1955, the following letter from R. J. Bopp, Chief Excise Tax Branch, Commissioner of Internal Revenue, Washington, D. C., was sent to appellant:

“AUTO NURSE MANUFACTURING COMPANY
41 Market Street
Venice, California

Attention: Mr. Irwin Aran

Gentlemen:

In your letters dated November 27 and December 29, 1954, you request a ruling as to whether a baby bottle warmer of your manufacture is subject to manufacturers' excise tax.

You state that your baby bottle warmer plugs into the cigarette lighter of an automobile and heats the baby bottle.

The baby bottle warmer described is not considered to be an automobile part or accessory and, therefore, is not subject to manufacturers' excise tax.

Very truly yours,

R. J. Bopp

CHIEF, EXCISE TAX BRANCH”

On February 14, 1955, appellant filed his claim for refund with the District Director of Internal Revenue in Los Angeles, California, and on May 4, 1956, appellant's claim for refund was disallowed, and on August 8, 1956, his appeal therefrom was rejected by Treasury Department, Appellate Division.

After taxpayer, appellant, had filed his claim for refund the Internal Revenue Service by letter dated December 8, 1955, notified appellant that it was reversing its prior decision of February 4, 1955. Appellant's baby bottle

warmers had not changed in use, or in any manner or capacity whatsoever during this time. Nor had the law in any way been altered, broadened, or made to include baby bottle warmers.

Subsequently appellant filed his complaint for refund in the United States District Court for the Southern District of California, Central Division. The Court in its Amended Findings of Fact and Conclusions of Law found that the sum of money which was paid by appellant during the four years immediately preceding the filing of the claim for refund on February 14, 1955, was \$6,877.99 and that if appellant would be entitled to a refund it would be in that amount since appellant had not passed the tax on to the ultimate consumer but had absorbed same in his cost and profit structure.

The Court further found that these baby bottle warmers were primarily adapted for use in connection with taxable vehicles and as such were subject to manufacturers excise tax as an automobile part or accessory, even though they were primarily used by parents with infant children and are primarily sold in baby, drug and department stores and have nothing to do with the operation, utility, or ornamentation of the automobile and are not useful to automobiles or motorists as a class. It is in part from these findings and conclusions that appellant appeals this matter.

Specification of Errors.

The Court Erred in Finding That Baby Bottle Warmers as Sold and Manufactured by Appellant Are Automobile Parts or Accessories Within the Language of Section 3403(c) of the 1939 Internal Revenue Code Under Which They Were Originally Taxed, and Sec. 4061(b) of 1954 I. R. C. Under Which They Are Now Taxed.

(1) The language of Section 3403(c) of the 1939 Internal Revenue Code clearly states what shall be considered parts or accessories for automobiles, whether or not primarily adapted for such use. In this connection that section provides:

“ . . . FOR THE PURPOSE OF THIS SUBSECTION AND SUBSECTIONS A AND B, SPARK PLUGS, STORAGE BATTERIES, LEAF SPRINGS, COILS, TIMERS AND TIRE CHAINS, WHICH ARE SUITABLE FOR USE ON OR IN CONNECTION WITH, OR AS COMPONENT PARTS OF ANY OF THE ARTICLES ENUMERATED IN SUBSECTIONS (A) AND (B) SHALL BE CONSIDERED PARTS OR ACCESSORIES FOR SUCH ARTICLES, WHETHER OR NOT PRIMARILY ADAPTED FOR SUCH USE. THIS SUBSECTION SHALL NOT APPLY TO CHASSIS OR BODIES FOR AUTOMOBILE TRUCKS OR OTHER AUTOMOBILES. . . .”

(Emphasis ours.)

Nothing therein contained provides for the taxation of baby bottle warmers as parts or accessories nor for any construction that *any* item primarily adapted for use in an automobile whether essential to its operation, utility or ornamentation or not shall be considered as an auto part or accessory.

The Judgment Is in Part Contrary to the Law and the Evidence.

(1) The lower court has misinterpreted the legislative intent as set forth in Section 3403(c) of the 1939 Internal Revenue Code, The legislature referred only to specific items which would be considered parts or accessories whether or not primarily adapted for use on *automobile chassis or bodies*, as provided in Subsections (A) and (B).

(2) The evidence clearly manifested that appellant's baby bottle warmers have no connection with the chassis or body of the automobile.

(3) The Treasury regulation commonly referred to as T. R. 46.316.55(c) as amended T. D. 5099, 1941-2 Cum. Bull. 267 has attempted to extend beyond the clear import of the language used in 3403(c) of the 1939 Internal Revenue Code the effect of the statute levying the tax, and a judgment for respondent here ratifies the language of that Treasury regulation.

(4) The legislature intended the tax to extend to the framework or body of the automobile and to parts or accessories connected with the performance, or ornamentation or utility thereof and not to baby bottle warmers which may be used in an automobile.

The Court Erred in Finding That Appellants Baby Bottle Warmers Were Not Equally Well Adapted to Other Uses and as Such Not Taxable as Auto Parts or Accessories.

(1) Evidence established that appellants baby bottle warmers had other uses which according to the law would avoid tax against such items as auto parts or accessories.

The Lower Court Erred by Improperly Applying the Primary Adaptability Test to Determine Whether Baby Bottle Warmers Are Auto Parts or Accessories, and in So Finding.

(1) The lower court improperly applied a primary adaptability test to determine whether baby bottle warmers are auto parts or accessories by not considering whether baby bottle warmers are essential to the operation, use or ornamentation of motor vehicles and in failing to consider that their use is limited to parents with infant children only.

Summary of Argument.

Appellant's baby bottle warmers are primarily used by parents with infant children and are found in baby, drug and department stores. They carry the Parents Magazine Seal of Approval and are not sold with, on or in connection with automobile chassis or bodies.

They are a convenience to parents with infant children and in no manner aid in the performance, ornamentation or utility of the automobile itself.

The statute under which they have been taxed and the new statute under which they are now being taxed, are not as broad as the Treasury Department would interpret them to be, nor was it intended by the legislature in the passage of these statutes for the tax to be assessed as it has been done to date by the Treasury Department.

The Treasury Regulation 46.316.55(c) as amended, T. D. 5099, 1941-2 Cum. Bull. 267, which apparently

attempts to embody Section 3403(c) goes far beyond the language of the statute which assesses the tax and as such should not be considered in determining whether baby bottle warmers are automobile parts or accessories. *In fact the Treasury Department chooses to disregard the fact that Congress did not see fit to impose tax on all articles used by persons while driving or riding in an automobile, and the lower court by its judgment erroneously has approved the language contained in that Treasury regulation which seeks to do so.* The mere fact that baby bottle warmers may be used more often in an automobile than elsewhere does not make them automobile parts or accessories. They in no way enhance the performance, utility or ornamentation of automobiles and as such the true intent of the legislature would hold these baby bottle warmers free from a manufacturers' excise tax as automobile parts or accessories. Further, motorists or automobiles as a group or class are in no way benefited by baby bottle warmers.

ARGUMENT.

Whether the Lower Court Erred in Determining That Baby Bottle Warmers as Manufactured and Sold by Appellant Are Automobile Parts or Accessories Within the Language of Section 3403(c) of the 1939 Internal Revenue Code and Its Present Counterpart.

Baby bottle warmers attached with a cord and plug for insertion into those automobiles containing a cigarette lighter socket are not automobile parts or accessories but baby parts or accessories.

They are designed for the convenience and luxury of modern day living to the end that they aid the bedraggled parents in maintaining their infant children while being able to move from one place to another, if desired.

The bottle warmer is not attached to the automobile, DOES NOT AID IN THE MOVE! It merely aids the parent in keeping the infant complacent during the move. It does not seem logical nor plausible that the legislature could possibly have intended to tax as automobile parts or accessories every item which may be used by persons while driving or riding in an automobile.

If that were the case the logical rationale would require the taxation as automobile parts or accessories to include such articles as, gloves, first aid kits, baby cribs, safety flares, prosthetic devices for disabled drivers, and similar articles primarily sold for use by motorists although wholly unrelated to the appearance, performance or utility of the automobile itself. *Baby bottle warmers are accessories to living, not automobiles.*

Automobile parts or accessories are found primarily in automobile stores; appellant's baby bottle warmers are sold, as manifested by the evidence, primarily in gift

stores, baby stores, department stores and drug stores. Certainly this is not indicative of an automobile part or accessory. How many automobile parts are used as baby shower gifts or found in baby stores? How many automobile parts are advertised in Parents Magazine or have received Parents Magazine seal of approval?

The language of Section 3403 and specifically Subsection (c) of that section invites the Court's investigation. (See App., *infra*.) In that section the legislature has said, among other things, that spark plugs, storage batteries, leaf springs, coils, timers and tire chains, which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in Subsections (a) and (b) shall be considered parts or accessories for such articles, whether or not primarily adapted for such use.

The legislature did not speak in terms of baby bottle warmers which might be used in automobiles and did not speak in terms of applying this section to every item which might be used in an automobile. The legislature further did not speak in terms of every item whether or not primarily adapted for such use. The use of the language *whether or not primarily adapted for such use* when examined in its context clearly manifests only an intention to tax as parts or accessories, whether primarily adapted for use thereon, or not, the articles enumerated in that section. It is not so broad as to include articles which may be used in automobiles but which have nothing to do with the performance, utility or ornamentation of the automobile. (I. R. C., 1939, Sec. 3403(c) *infra*; I. R. C., 1954, Sec. 4061(b).)

It would have been a simple thing for the legislature to have included such a meaning if they had intended to do

so in the first instance, or at any time thereafter. But having failed to do so, it is submitted that to tax as in this instance, baby bottle warmers as auto parts or accessories, is inconsistent with the intent set forth in the taxing statute and inconsistent with the language and effect thereof.

It Is Apparent That What the Legislature Had in Mind at the Time of the Passing of Section 3403(c) of the 1939 Internal Revenue Code Was a Tax on Items Which Were Primarily Connected With the Intimate Operation, Function, Utility and Ornamentation of the Motor Vehicle.

The generic meaning of part or accessory clearly manifests that appellant's baby bottle warmers cannot be included.

Smith v. McDonald, 214 F. 2d 920.

If baby bottle warmers were parts or accessories, would it not necessarily follow that upon the sale of such vehicle to which they constituted a part or accessory thereof, that they would necessarily be sold along with the vehicle? Does one generally sell his vehicle without all of its parts or accessories?

Whether or Not Baby Bottle Warmers Are Automobile Parts or Accessories Under the Language of the Statute in Point Depends Upon a Reasonable Construction of the Statute in Question.

The mere fact that any item may be used in an automobile and used there more often than other places is not decisive to classify the article as an auto part or accessory under the statute involved herein.

McCaughn v. Electric Storage Battery Co., 63 F. 2d 715.

The Automobile Must Be Primarily Adapted to the Baby Bottle Warmer Before It May Even Be Used in an Automobile.

The baby bottle warmer is not primarily adapted for use in a motor vehicle. The auto must be adapted to the baby bottle warmer before it may even be used as a warmer in an auto. If the vehicle is not equipped with a cigarette lighter socket (which is not uncommon) the baby bottle warmers are not usable in an auto or motor vehicle. They are not of general use to motorists and are not primarily adapted to an automobile. If the auto or motor vehicle is not adapted to the warmer there can be no connection with the automobile in any respect, except perhaps in one of the other usages which these baby bottle warmers may be placed. (*Cuno Eng. Corp. v. United States*, 43 F. 2d 259 at 262 (Ct. Cl. 1930).) Therefore it would seem that the language of the statute did not contemplate all products which were primarily or remotely adapted to motor vehicles and in that connection to their intimate operation, use, utility or ornamentation.

In *Smith v. McDonald*, a Third Circuit case decided in 1954, 214 F. 2d 920, the Court had a similar situation before it. That case involved signs designed primarily to be adapted and attached to taxicabs or automobiles. (All taxable vehicles under Sections 3403(c) and 4061(b) as presently interpreted.) These signs were attached to the roofs of these automobiles and apparently operated from the electrical system of the automobile itself. The lower court in 116 Fed. Supp. 158 held that this item was primarily designed and adapted for use on or in connection with automobiles under Section 3403(c) whether it aided functionally the automobile or not. On appeal the learned

Appellate Court stated that each case must rest upon its own facts and it is not merely a part or accessory because it was primarily used in connection with an automobile. The Court reasoned that these signs were accessories to the automobile operators' business and NOT the motor vehicle. Further the Court went on to say that the motor vehicle was in no way aided in its performance, utility or did it function in a better manner. And the court held that the statute was not so broad as to tax every item which might be used by motorists, while operating or using the motor vehicle, thereby reversing the lower court.

By analogy appellant's baby bottle warmers fall within the same category. They are an aid to the parents with infant children. They are accessories to the parent with such children. Furthermore, the *McDonald* case involved an item which could be used on any automobile, whereas appellant's baby bottle warmers can only be used as a warmer in those motor vehicles equipped with cigarette lighter sockets. The Treasury regulation involved in the *McDonald* case contains the same language as the one now before this court, and even in the face of its broad language making any item primarily adapted for use in an automobile whether essential to its operation or not the appellate court reversed the trial court.

It is therefore urged of this Honorable Court that the lower court be reversed and a finding be made that appellant's baby bottle warmers are not parts or accessories of motor vehicles taxable under Sections 3403(c) or 4061(b) of the 1939 and 1954 Internal Revenue Codes, respectively.

Whether Treasury Regulation 46.316.55(c), as Amended, T. D. 5099, 1941-2 Cum. Bull. 267, Is an Unreasonable Interpretation of the Statute Upon Which It Is Based and as Such Inapplicable to Impose a Tax Upon Baby Bottle Warmers Usable in Automobiles.

Any regulation adopted by the Commissioner or Treasury Department *must* bear a reasonable relationship to the statute itself and not to a construction placed thereon by said department.

Smith v. McDonald, 214 F. 2d 920;

Gould v. Gould, 245 U. S. 151, 61 L. Ed. 211;

United States v. Merriam, 263 U. S. 179, 68 L. Ed. 240.

T. R. 46.316.55(c) as amended T. D. 5099, 1941-2 Cum. Bull. 267, bears no reasonable relationship to the statute upon which it is based, namely 3403(c) of the 1939 I. R. C. now 4061(b) of the 1954 I. R. C. The treasury department themselves are apparently confused as to the law and interpretation to be placed on both the statute and their regulation.

This is clearly shown by the letter written to appellant on February 4, 1955 (*supra*) wherein they advise appellant that his baby bottle warmers are not considered by them as auto parts or accessories under the statutes and regulation involved herein. Neither the statutes nor regulation had changed in effect at any time during this taxing period yet approximately 10 months later, and after appellant had made his application for refund the treasury department reversed its February 4, ruling.

This it is conceded is most unusual. Neither the law nor the bottle warmer had changed in any substantial

manner. The same treasury regulation was before the department when it made its ruling on February 4, 1955, and the baby bottle warmers were then adapted for the same uses as thereafter. It can only be said in passing that the Treasury Departments application of this Treasury Regulation is as confusing as the actual basis for the passage of such a regulation in the first instance.

The statute upon which it is allegedly based, certainly does not permit the levying of this tax upon articles primarily adapted for use in motor vehicles, whether essential to their operation or not. Case law on the other hand strongly reveals the incorrectness of such a regulation and correctly indicates that there must be some connection with the function, utility or ornamentation of the item involved before it might be considered a part or accessory. (*Smith v. McDonald*, 214 F. 2d 920; *Johnie & Mack, Inc. v. United States*, 123 Fed. Supp. 400.)

In *Cuno Eng. Corp. v. United States*, 43 F. 2d 259-252, the appellate court in a most similar situation as the one presently at bar, decided that electric cigar and cigarette lighters usable in automobiles were not subject to the excise tax in question as a part or accessory. The treasury regulation then provided that any article which was primarily adapted for use in connection with an auto, whether essential to its use or not was such an item as to be considered as a part or accessory for purposes of the tax.

The court said that the product did not prolong the life of the car nor aid in the operation thereof and that even though the treasury regulation had construed the applicability of such statute to exist against products whether essential to the autos use or not, that in the case of cigarette lighters for autos they were merely for the convenience of smokers or for their luxury and this did in no way add

to the utility of the car or prolong its operation or life.

The court said that the taxing statute could not be construed by the court like the regulation would have it. They went on to say that obviously a clear distinction prevails as was within the intent of the Revenue Act between an extraneous article or devise capable and designed to be used as an item of luxury and comfort of the occupant and to items intimately connected with the autos safe operation, function, utility or ornamentation.

Even though cigarette lighters may today be a taxable item as an auto part or accessory the reasoning of this decision stands on its own two feet in both a logical and reasonable interpretation of both the statute and regulation.

Appellants baby bottle warmers are designed for the convenience and luxury of parents with infant children, and in no way prolong the life of the vehicle or add in any manner to its operation, function, utility or ornamentation. By utility is meant function, by ornamentation is meant beauty.

The Treasury Department has held that emblems designed only to be attached to automobiles to show membership in auto clubs and societies are not taxable. (S. T. 409, II-1 C. B. 285.) How can this be reconciled wherein they are primarily adapted for use on the auto though not essential to the operation thereof? There are too many inconsistencies in the attitude of the Treasury Department and it is incumbent upon this court to clearly show the way and properly interpret Section 3403(c) of the 1939 I. R. C. and its present counterpart Section 4061(b) of the 1954 I. R. C.

Under a revenue ruling grease kits sold separately, even though primarily adapted for use on rear axles of automobiles are not taxed as parts or accessories of automobiles. (53 Rev. Ruling, 166.) Tire pressure gauges are not subject to tax on auto parts even though principally used by service stations and garages and primarily adapted for use on automobile tires. (Rev. Ruling, 55-304.) All of these rulings clearly manifest a complete lack of understanding of the true intent of the legislature in connection with what is to be taxed and what is not to be taxed as auto parts or accessories under Section 3403(c) of the 1939 I. R. C. and 4061(b) of the 1954 I. R. C.

It is submitted therefore that baby bottle warmers were not contemplated by the legislature to be included within the language of 3403(c) or its present day counterpart and as such the lower court erred in its finding that appellants baby bottle were auto parts or accessories.

Whether the Court Erred in Using the Primary Adaptability Test in Determining Whether Baby Bottle Warmers Are Automobile Parts or Accessories as Included Within the Language of Section 3403(c) of the 1939 I. R. C. Now Section 4061(b) of the 1954 I. R. C.?

Primary adaptability means that the product is itself intimately connected with the function, operation, utility, or ornamentation of the motor vehicle. It goes no further than this. (*Smith v. McDonald*, 214 F. 2d 920; *Cuno Eng. Corp. v. United States*, *supra*.)

The court in applying the primary adaptability test in this matter failed to take into consideration whether or not baby bottle warmers aid in the performance, utility or ornamentation but apparently rendered its decision based

upon the fact that appellants baby bottle warmers are used in automobiles and other motor vehicles more often than other places and ignored the fact that the baby bottle warmer has limited use, only to parents with infants, and not useful to auto owners as a class. However, the law is clear in this regard. Even the intention of the manufacturer has nothing to do with the actual utility of the article for determining whether it is subject to the tax or not. (*American Chain Co. v. Hartford Conn. Trust Co.*, 11 Fed. Supp. 770.) The fact that automobiles are the place where appellants baby bottle warmers are used more often than elsewhere in *not decisive* to classify said items as auto parts or accessories under the code, nor to classify them as primarily adapted for use in automobiles. (*McCaughn v. Electric Storage Battery Co.*, 63 F. 2d 715.)

The statute itself is the only measure to be used in determining what are or are not parts or accessories for automobiles or motor vehicles. Certainly the legislature did not intend to tax as auto parts or accessories any item which might be used in the auto and primarily adapted for use in the auto though not essential to its operation. The primary adaptability is a test which the courts seem to have evolved as the criterion for determination or classification of the item or product involved. The courts themselves have in effect adopted a test which the statute does not provide, but case decision may permit taxation in this record if the product in some reasonable manner aids in the operation, function or ornamentation of the vehicle. The only basis therefore to determine what shall be considered as a part or accessory must be a reasonable and logical examination of the item involved, examined in the light of human knowledge, reason and understanding.

Under a revenue ruling grease kits sold separately, even though primarily adapted for use on rear axles of automobiles are not taxed as parts or accessories of automobiles. (53 Rev. Ruling, 166.) Tire pressure gauges are not subject to tax on auto parts even though principally used by service stations and garages and primarily adapted for use on automobile tires. (Rev. Ruling, 55-304.) All of these rulings clearly manifest a complete lack of understanding of the true intent of the legislature in connection with what is to be taxed and what is not to be taxed as auto parts or accessories under Section 3403(c) of the 1939 I. R. C. and 4061(b) of the 1954 I. R. C.

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Appellants baby bottle warmers examined in this light has limited use and can only be classified as baby accessories designed for the convenience of parents with infant children, and certainly not auto parts or accessories.

Whether the Court Erred in Finding That Appellants Baby Bottle Warmers Are Not Equally Adaptable to Other Uses and Hence Not Subject to Tax Under Section (c) of the 1939 I. R. C. and Section 4061(b) of the 1954 I. R. C.

An article even though designed primarily for use in an auto but being equally adaptable for other uses, is not taxable as an auto part or accessory. (*McCaughn v. Electric Storage Battery Co.*, *supra*.)

In the latter case storage batteries were used primarily in cars and prior to the amendment of the statute they were held not to be parts or accessories due to their other equally adaptable uses.

What are the uses of appellants baby bottle warmers?

The evidence revealed that they may be used as baby gifts; to insulate and retain temperature for periods of time without any connection to the automobile; to act as a holder of the baby's bottle before use as a warmer, or after warmed. Certainly these baby bottle warmers are equally adapted to each such use. Again the manufacturers intent has no bearing whatsoever on this point. (*American Chain* case, *supra*.) Being equally adaptable to other uses they cannot be taxed as in the case at bar, as automobile parts or accessories.

Conclusion.

Since the baby bottle warmers in question are primarily designed for use by parents with infant children and are not items which are generally used by motorists as a class it would seem *ergo* that the Internal Revenue Department in applying Section 3403(c) has failed to understand the legislative intent thereof and has adopted a Treasury Regulation with an unrealistic attitude and an attempt to encompass a field in which it should have no control according to legislative intent.

It is submitted to this Honorable Court that unconstitutional practices get their start in small ways and then continue on. It appears that the Internal Revenue Service intended, unjustifiably, that a snowball be formed, and that it be extended into an encroachment upon any product which might in some manner be used on or in motor vehicles. Disregarding logic and understanding the Internal Revenue Department in this field is attempting to avail itself of the fruits of its acts in order to accomplish complete control over commerce, business and private enterprise.

In a Government of Laws, Existence of the Government Will Be Imperiled If It, Its Agents and Employees Fail to Observe the Law Scrupulously.

The Treasury Department in its zeal has usurped the function of the legislature and it is submitted therefore that the lower court in accepting the Treasury Department's interpretation, regulation and explanation of Section 3403(c) of the 1939 I. R. C. and its present counterpart has erred, and such error should be reversed by this Honorable Court.

The record, the law and the evidence in this case at bar fails to reveal any grounds upon which baby bottle warmers may properly be taxed as an auto part or accessory and as such it is respectfully urged that the judgment of the lower court be in part reversed and judgment be rendered in favor of appellant for refund in the sum of \$6,877.99.

Respectfully submitted,

ROBERT M. ARAN,

Attorney for Appellant.

APPENDIX A.

Section 3403, 1939 Internal Revenue Code:

Sec. 3403, as amended: There shall be imposed upon the following articles sold by the manufacturer, producer or importer a tax equivalent to the following percentages of the price for which so sold:

(A) Automobile Truck Chassis, Automobile truck bodies, Automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (Including in each of the above cases parts or accessories therefore sold on or in connection therewith or with the sale thereof, 8% except that on and after April 1, 1955 the rate shall be 5%.) A sale of an automobile truck, bus or truck or bus trailer or semitrailer shall for the purpose of this subsection be considered to be a sale of the chassis and of the body.

(B) Other automobiles chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles and motorcycles (including in each case parts or accessories therefore sold on or in connection therewith or with the sale thereof) except tractors, 10% except that on and after April 1, 1955 the rate shall be 7%. A sale of an automobile, trailer, or semitrailer shall, for the purpose of this subsection be considered to be a sale of the chassis and of the body.

(C) Parts or accessories (other than tires and inner tubes and other than radio or television receiving sets) for any of the articles enumerated in subsections (A) or

(B) 8% except that on and after April 1, 1955 the rate shall be 5%. *“For the purpose of this subsection and subsections A and B, spark plugs, storage batteries, leaf springs, coils, timers and Tire chains, which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in subsections (A) and (B) shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. This subsection shall not apply to chassis or bodies for automobile trucks or other automobiles. . . .”*

In the United States Court of Appeals
for the Ninth Circuit

IRWIN ARAN, doing business as AUTO NURSE
MANUFACTURING COMPANY, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States
District Court for the Southern District of California

BRIEF FOR THE APPELLEE

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In the United States Court of Appeals
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No. 15741

IRWIN ARAN, doing business as AUTO NURSE
MANUFACTURING COMPANY, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States
District Court for the Southern District of California

BRIEF FOR THE APPELLEE

OPINION BELOW

The amended findings of fact, conclusions of law and judgment of the District Court (R. 35-39) are not yet reported.

JURISDICTION

This appeal involves manufacturer's excise taxes in the amount of \$6,877.99 paid between February 14, 1951, and November 17, 1954. (R. 35-36.)¹ Tax-

¹ The complaint asked for a refund of \$8,208.62 paid between April 1, 1949, and November 17, 1954, (R. 3, 20), but the District Court held that only the sum of \$6,877.99 was paid during the four years immediately preceding the filing

payer filed a claim for refund on February 14, 1955, which was disallowed on August 8, 1956. (R. 21.) Taxpayer's complaint in this action was filed against the United States in the District Court for the Southern District of California on September 12, 1956 (R. 1-4), or more than six months after the filing of the claim for refund and within the time provided in Section 3772 of the Internal Revenue Code of 1939, for refund of amounts which had allegedly been paid erroneously. Jurisdiction was conferred on the District Court by 28 U.S.C. Section 1340. Judgment was entered in favor of the United States on May 16, 1957. (R. 39.) Within 60 days, and on July 11, 1957, the taxpayer filed a notice of appeal. (R. 40.) Jurisdiction is conferred on this Court by 28 U.S.C. Section 1291.

QUESTION PRESENTED ²

Did the District Court err in holding that baby bottle warmers manufactured and sold by the taxpayer, which operate by electrical connection with an automobile cigarette lighter receptacle, are taxable as an automobile accessory within the meaning of

of the taxpayer's claim for refund on February 14, 1955, and that \$1,330.63 of the amount originally claimed paid between May 31, 1949, and February 14, 1951, was barred by the four-year period of limitations specified in Section 3313 of the Internal Revenue Code of 1939 as amended by Section 207(b) (2), Social Security Act Amendments of 1950, c. 809, 64 Stat. 477 (R. 35-36, 37). The taxpayer has not appealed from that holding. (R. 40, 47-48).

² Neither the taxpayer nor the United States has appealed from the decision on other issues. (R. 40, 47-48).

Section 3403(c) of the Internal Revenue Code of 1939?

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and Treasury Regulations are printed in the Appendix, *infra*.

STATEMENT

The facts as stipulated by the parties (R. 20-22) and as found by the District Court (R. 35-37) may be summarized as follows:

During the time in question, taxpayer was the manufacturer of baby bottle warmers fitted with a cord and connection capable of being inserted into the cigarette lighter of automobiles equipped with such a lighter. These bottle warmers are primarily used by parents with infant children and are primarily sold in baby, drug and department stores. (R. 20, 37.)

In a letter from the United States Treasury Department dated February 4, 1955, signed by R. J. Bopp, Chief, Excise Tax Branch, it was ruled that taxpayer's baby bottle warmer is not considered to be an automobile part or accessory, and, therefore, is not subject to manufacturers' excise tax. By letter dated December 8, 1955, the Internal Revenue Service notified taxpayer that it had given further consideration to the ruling made by it on February 4, 1955, and now concludes that taxpayer's baby bottle warmer as described in taxpayer's letter of November 27, 1954, is primarily designed and adapted for use in connection with vehicles taxable under section 4061

(a) of the 1954 Internal Revenue Code and that its ruling to taxpayer under date of February 4, 1955, was reversed, making taxpayer's baby bottle warmers subject to the tax above. (R. 20-21.)

The District Court found that taxpayer's baby bottle warmers were primarily adapted for use in connection with taxable vehicles and not equally well adapted for other uses within the meaning of Section 3403(c) of the Internal Revenue Code of 1939 and held that they are, therefore, subject to manufacturers' excise tax as an auto part or accessory. (R. 35-38.) From that decision the taxpayer has appealed to this Court. (R. 40.)

SUMMARY OF ARGUMENT

The sales of baby bottle warmers were taxable as sales of automobile accessories by the taxpayer manufacturer within the meaning of Section 3403 of the Internal Revenue Code of 1939. It is clear that the articles in question, which operate by means of an electrical connection with the cigarette lighter on automobiles, fall within the term "parts or accessories" under the statute as interpreted by the Treasury Regulations inasmuch as the primary use of the baby bottle warmers is in connection with an automobile. Congress could not have intended to tax only parts and accessories enumerated in the statute, for it would have been futile for it to have enumerated all automobile parts and accessories, particularly in view of the many changes and improvements constantly occurring in this field. The Regulations,

which were reasonably designed to give effect to Congressional intention, have been in effect for many years, during which time the statute has been re-enacted in substantially similar terms.

Under the Treasury Regulations, a taxable article need not be essential to the operation or use of an automobile. Moreover, the baby bottle warmers here in question were not equally well adapted for other uses than in connection with an automobile, as the District Court found. Whatever use they may have had as heat retainers or bottle holders was incidental to their primary use to warm bottles which could not be done except by electrical connection with the cigarette lighter of an automobile. The record clearly supports the District Court's findings, and the taxpayer failed to carry the burden of proving that the primary purpose of the articles was other than in connection with automobiles.

The Treasury Department has consistently ruled that similar articles, such as heating pads, utility lights, and air conditioning units, designed to operate from a cigarette lighter plug in an automobile, are taxable as automobile accessories. That the Treasury Department earlier ruled that taxpayer's baby bottle warmers were not taxable is immaterial, inasmuch as the Commissioner can, even with retroactive effect, remedy prior incorrect rulings.

ARGUMENT

The Sales Of Baby Bottle Warmers Were Taxable As
Sales Of Automobile Accessories By The Taxpayer
Manufacturer Within The Meaning Of Section 3403
Of The Internal Revenue Code Of 1939

The sole issue in this case is whether taxpayer is entitled to a refund of manufacturer's excise taxes paid on the sales of baby bottle warmers which he manufactured and sold. These articles operate by means of an electrical connection with the cigarette lighter on automobiles. The taxpayer questions (Br. 10-20) the District Court's finding (R. 36, 38) that the baby bottle warmers were primarily adapted for use in connection with a taxable vehicle within the meaning of Code of 1939 Section 3403(c), and asserts that in order to be an automobile accessory within this section of the Code an article must aid in the performance, utility, or function of the automobile itself. He contends (Br. 15-16) that the Treasury Regulations defining automobile accessories are unreasonable extensions of the statute, and that Congress must have intended to tax only articles which aid directly in the operation, function, or ornamentation of the vehicle. It is submitted that there is no merit to these contentions, and that the District Court was correct in holding the baby bottle warmers subject to the manufacturer's excise tax as an automobile accessory.

Section 3403(c) of the Internal Revenue Code of 1939, Appendix *infra*, provides that an 8% tax³

³ For a brief period here involved prior to November 1, 1951, the tax rate was 5%.

shall be imposed on automobile parts or accessories, with certain exceptions not material here. Treasury Regulations 46, Section 316.55, Appendix *infra*, define "parts or accessories" to include:

(a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (c) any article the primary use of which is in connection with such vehicle or article *whether or not essential to its operation or use*. (Italics supplied.)

It is clear that the baby bottle warmers here in question fall within the term "parts or accessories" under the statute as interpreted by the Treasury Regulations for, contrary to taxpayer's contention (Br. 10-20), the primary use of the baby bottle warmers is in connection with an automobile. The District Court so found, and stated specifically that the articles were not equally well adapted for uses other than in connection with an automobile. (R. 36, 38.)

Whether certain articles are primarily adapted for use on automobiles so as to constitute "parts and accessories" within the meaning of the Code is a question of fact in each case. *Benmatt Organization, Inc. v. United States*, 236 F. 2d 959 (C.A. 9th), affirming *per curiam* 134 F. Supp. 511 (S.D. Cal.). Where, as here, the findings of the court below are clearly supported by the evidence, they should not be disturbed on appeal unless clearly erroneous. *United States v. Real Estate Boards*, 339 U.S. 485; *United States v.*

Gypsum Co., 333 U.S. 364, rehearing denied, 333 U.S. 869.

There is no merit to taxpayer's argument (Br. 11) that Congress intended to tax only articles enumerated in the statute. To enumerate the various parts or accessories for automobiles would have been well-nigh impossible and practically futile as changes and improvements are being made constantly and new or different accessories are being devised. Congress, therefore, used generic terms with the intention that the provision would be construed to effectuate its purpose. The Treasury Regulations were designed to give effect to the intention of Congress and to resolve difficulties in administering the law. It is submitted that these Regulations reasonably interpret and apply the law.

As early as 1919, Article 16 of Regulations 47 provided that all articles primarily adapted for use in connection with an automobile were taxable as automobile parts or accessories. In subsequent years the provisions of the Code and Treasury Regulations interpreting the taxation of automobile accessories have remained substantially unchanged. Treasury Regulations and interpretations long continued without substantial change, applying substantially re-enacted statutes, are deemed to have received Congressional approval and have the effect of law. Indeed, in *Masao Hirasuna v. McKenney*, 245 F. 2d 98, 100, this Court applied and approved the selfsame section of the Regulations, which taxpayer attacks. See also *United States v. Armature Exchange, Inc.*, 116 F. 2d 969, 971 (C.A. 9th), certiorari denied, 313 U.S. 573; *Corn*

Products Co. v. Commissioner, 350 U.S. 46; *Helvering v. Winmill*, 305 U.S. 79.

Under the provisions of the Treasury Regulations quoted above, if the primary use of an article is in connection with an automobile, it is a part or accessory, and it need not be essential to the operation or use of the automobile. Taxpayer is thus in error in arguing (Br. 16) that to be taxable an article must be related to the function, utility or ornamentation of the automobile. Furthermore, under the Regulations it is clear that if, as here, an article is designed primarily for use on an automobile, the fact that it is susceptible of some other uses for which it is not so well adapted does not relieve the manufacturer of the tax on its sale. In *Universal Battery Co. v. United States*, 281 U.S. 580, the Supreme Court stated that it would be unreasonable to hold that articles can be classified as parts or accessories only where they are adapted solely for use in motor vehicles and are exclusively so used. It stated (p. 584):

We think the view taken in the administrative regulations is reasonable and should be upheld. It is that articles primarily adapted for use in motor vehicles are to be regarded as parts or accessories of such vehicles, even though there has been some other use of the articles for which they are not so well adapted.

See also *Benmatt Organization, Inc. v. United States*, 236 F. 2d 959 (C.A. 9th), affirming *per curiam* 134 F. Supp. 511 (S.D. Cal.); *Masterbilt Products Corp. v. United States*, 42 F. Supp. 294 (C. Cls.).

Taxpayer argues (Br. 20) that his baby bottle

warmers were equally adapted to other uses. That some may have been bought as gifts, however, does not deny that the primary *use* of the article was in connection with an automobile. They were sold as *bottle warmers*, and taxpayer advertised them as the "Auto Nurse" and on his business stationery printed a picture of an automobile with the statement "Auto Nurse warms Baby's food—on the Go!" Taxpayer argues (Br. 19, 20) that the intent of the manufacturer does not control taxability of the article. However, this Court can hardly be expected to find that the articles were not what taxpayer said they were in his own advertisements. See *Red Star Yeast & Products Co. v. LaBudde*, 83 F. 2d 394 (C.A. 7th). That the articles may have been suitable for keeping food hot without any connection to the automobile again does not gainsay that primarily they were sold as *bottle warmers*, and would have to be connected with the automobile to get food hot before it could remain so. Their use as a bottle holder was certainly incidental to their primary purpose of warming bottles. (R. 85.) *There was no way in which these articles could warm bottles except in connection with an automobile, unless the purchaser obtained a converter to adapt the article for home use.* (R. 82-86.) The taxpayer, however, did not sell such converters (R. 83-84), and to obtain one would naturally add considerably to the initial cost of the device.⁴

⁴ The wholesale price charged by taxpayer for the bottle warmers depending upon the model was \$1.33 and 75 cents to 89 cents (R. 65); the cost of a converter was quoted to him at 89 cents. (R. 84.)

There is nothing in the record before this Court to refute the finding of the District Court (R. 36) that the primary purpose of the bottle warmers was use in connection with automobiles; indeed the record fully sustains this finding. The taxpayer failed to carry his burden of proving otherwise. In *Perfection Gear Co. v. United States*, 41 F. 2d 561, the Court of Claims had for consideration the question of whether certain timing gears were taxable as parts for automobiles. In sustaining the defendant's position, the court observed (p. 562):

When the primary and chief use of an article is established that subjects it to the tax, the manufacturer can not escape the tax upon his entire sales by showing that the article could and may have been used for some other purpose, without showing the number of those sold and taxed that were so used.

In S. T. 834, XV-1 Cum. Bull. 396 (1936), baby auto seats, auto beds, and auto hammocks were held to be taxable automobile accessories inasmuch as they were designed for use in connection with an automobile. Again, in Rev. Rul. 57-231, and Rev. Rul. 57-232, 1957-22 Int. Rev. Bull. 12, 13, heating pads and utility lights which are primarily designed to operate from a cigarette lighter or similar outlet in an automobile electrical system were held to constitute automobile parts or accessories and subject to the manufacturers excise tax imposed by Section 4061(b) of the Internal Revenue Code of 1954, which is substantially similar to the section of the 1939 Code here in question. Likewise, in Rev. Rul. 56-544, 1956-2 Cum.

Bull. 797, the manufacturers' excise tax was held applicable to air-conditioning units which are designed for operation from a cigar or cigarette lighter plug of an automobile. Thus the Treasury Department is consistently ruling that articles such as the baby bottle warmers here in question, equipped with an electrical connection permitting them to be inserted into the cigarette lighter receptacle of an automobile, thus utilizing the electrical wiring system of the automobile as well as the source of electricity therein, are primarily designed to be attached to, and used in, the automobile, and therefore are parts or accessories within the meaning of Code of 1939 Section 3403(c).

Taxpayer attempts (Br. 15-16) to attach some significance to the fact that the Treasury Department first ruled that taxpayer's baby bottle warmers were not taxable, but within a year decided that they were and issued a published ruling to that effect, Rev. Rul. 56-293, 1956-1 Cum. Bull. 505. It is clear, however, that the Commissioner can, even with retroactive effect,⁵ remedy prior incorrect rulings. The Commissioner is not bound by his own or his predecessor's prior mistakes of law. *Automobile Club of Michigan v. Commissioner* 353 U.S. 180; *Campbell v. Brown*, 245 F. 2d 662, 666 (C.A. 5th); *Chiquita Mining Co. v. Commissioner*, 148 F. 2d 306 (C.A. 9th); *Tonningsen v. Commissioner*, 61 F. 2d 199 (C.A. 9th); *Goldfield Consol. Mines v. Scott*, 247 U.S. 126.

⁵ Here, of course, the ruling of which taxpayer complains, had no retroactive effect. Thus, the taxable period was February 14, 1951, to November 17, 1954 (See fn. 1 *supra*) the mistaken ruling was made on February 4, 1955 (R. 20-21) and corrected under date of December 8, 1955. (R. 21.)

The cases of *Cuno Engineering Corp. v. United States*, 43 F. 2d 259 (C.Cls) ; and *Smith v. McDonald*, 214 F. 2d 920 (C.A. 3d), relied on by the taxpayer (Br. 12, 13, 14, 15, 16, 18), are distinguishable on their facts, as pointed out in *Benmatt Organization v. United States*, *supra*. In the *Cuno* case, *supra*, the Court of Claims held in effect that the cigar lighter in question was equally well adapted for use other than in connection with an automobile; and in the *McDonald* case, *supra*, the Third Circuit held that the character and use of electric signs on taxicabs were analogous to the character and use of taxi meters which are expressly excluded from the tax on parts or accessories. These cases are in no way analogous to the instant situation.

CONCLUSION

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1939:

SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

(a) [as amended by Section 544 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 481 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof) 8 per centum, except that on and after April 1, 1954, the rate shall be 5 per centum. A sale of an automobile truck, bus, or truck or bus trailer or semitrailer, shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(b) [as amended by Sec. 481 (b) of the Revenue Act of 1951, *supra*] *Other Chassis and Bodies, Etc.*—Other automobile chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum, except that on and after April 1, 1954, the rate shall be 7 per centum. A sale of an automobile, trailer, or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(c) [as amended by Sec. 544 (b) of the Revenue Act of 1941, *supra*; Sec. 605 (c) (1) of the Revenue Act of 1950, c. 994, 64 Stat. 906; and Sec. 481 (c) of the Revenue Act of 1951, *supra*] ~~Sec. 601 (a) (8) of the Excise Tax Reduction Act of 1954, c. —.~~ Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b), 8 per centum, except that on and after April 1, 1955, the rate shall be 5 per centum. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 3403.)

Treasury Regulations 46 (1940 ed.):

Sec. 316.55 [as amended by T. D. 5099, 1941-2 Cum. Bull. 267, and T. D. 5854, 1951-2 Cum. Bull. 205] *Definition of parts or accessories.*—The term “parts or accessories” for an automobile truck or other automobile chassis or body, taxable tractor, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use. However, such term does not include tires, inner tubes, or automobile radio or television receiving sets, since these articles are expressly excluded by the statute from the tax on parts or accessories. With respect to fare registers and fare boxes for use on buses and automobiles, see section 316.140.

The term “parts and accessories” shall be understood to embrace all such articles as have reached such a stage of manufacture that they are commonly or commercially known as parts and accessories whether or not fitting operations

are required in connection with installation. The term shall not be understood to embrace raw materials used in the manufacture of such articles.

Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, automobile truck or other automobile chassis, taxable tractors, or motorcycles, are considered parts of or accessories for such articles whether or not primarily designed or adapted for such use.

* * * *

No. 15741

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IRWIN ARAN d/b/a AUTO NURSE MANUFACTURING COM-
PANY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District
Court for the Southern District of California.

REPLY BRIEF OF APPELLANT.

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PAUL H. GILBERT, CLERK

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No. 15741

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IRWIN ARAN d/b/a AUTO NURSE MANUFACTURING COMPANY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

REPLY BRIEF OF APPELLANT.

The appellee has failed to answer our contentions in this case. It argues that the lower court did not err by its decision that baby bottle warmers specifically made for the use and convenience of parents with small children and not for automobiles as a general class are parts or accessories of a motor vehicle as defined by Section 3403(c) of the 1939 Internal Revenue Code, simply because it may be used by drawing energy from the automobile to heat the bottle.

Appellee cites as its authority for such an interpretation the very Treasury Regulation which the appellant has attacked as an unreasonable interpretation of the statute upon which it is allegedly based.

Appellee points to no decision which would make this Treasury Regulation the law, nor to any decision that only Congress could alter the effect of a Treasury Regulation of long standing. To the contrary, the rule cited by appellee is no more than an aid in statutory construction, without the legal effect of binding any competent Court thereto. Where, as here, a statute has been incorrectly applied by an administrative regulation, the Court has the power to declare an important application, and basis for this Treasury Regulation. (*United States v. Missouri Pacific Railroad*, 278 U. S. 269, 73 L. Ed. 322.)

Where construction of a statute is doubtful, or where not uniform, any weight to administrative interpretation is inapplicable. (*United States v. Missouri Pacific Railroad Co. (supra).*)

Appellee argues the long standing of this Treasury Regulation 46.316.55 amended by T. D. 5099, 1941-2 Cum. Bull. 267 as law, yet its own Treasury Department on February 4, 1955 in a ruling by its chief of the Excise Tax Division, and not by a subordinate employee, found appellant's baby bottle warmers NOT to be auto parts or accessories within the meaning of Internal Revenue Code, Section 3403(c), and the aforementioned treasury regulation. Are we then to infer that the Treasury Department activities in this field are outside the scope of Congressional approval, or are we to infer that in truth and fact this treasury regulation has not received such Congressional approval as the appellant would have us believe? Clearly the Treasury Department is confused as to the application of this allegedly long standing regulation. AND THIS CONFUSION HAS RESULTED IN THE IMPROPER TAXING OF BABY BOTTLE WARMERS AS AUTO PARTS OR ACCESSORIES.

Obviously the chief of the Excise Tax Division realized that TAX LAWS ARE TO BE INTERPRETED LIBERALLY IN FAVOR OF TAXPAYERS AND LANGUAGE USED MAY NOT BE EXTENDED BEYOND ITS CLEAR IMPORT (*Miller v. Standard Nut Margarine Co.*, 284 U. S. 498 at 508) and that ALL DOUBT MUST BE RESOLVED AGAINST THE GOVERNMENT AND IN FAVOR OF THE TAXPAYER. (*Miller v. Standard Nut Margarine Co. (supra)*; *United States v. Merriam*, 263 U. S. 179; *Bowers v. N. Y. & A. Lighterage Co.*, 273 U. S. 346 at 350.)

As far as appellant can ascertain there are no rulings of the Treasury Department stressing the taxability of baby bottle warmers as auto parts or accessories. The only ruling we can point to in this regard is the one dated February 4, 1955, which was withdrawn after appellant made application for refund.

If as the appellee contends the Commissioner of Internal Revenue is not bound either by administrative interpretation or equitable estoppel to an erroneous construction of the law, so should the taxpayer be permitted to enjoy the same rights, and not be bound by an erroneous treasury regulation. (*Campbell v. Brown*, 245 F. 2d 662.)

The Treasury Department has construed the language of the statute, which is clear upon its face, to include as taxable as an auto part or accessory any article the primary use of which is in connection with a motor vehicle, whether or not essential to its operation, when in truth and in fact, no such language can be found in the statute, nor can any reasonable or logical interpretation to include or infer such effect be made.

We know this Honorable Court recognizes the rule that the LITERAL MEANING OF WORDS CAN BE INSISTED ON IN RESISTANCE TO A TAXING STATUTE. (*United States v. Armature Exchange, Inc.* (9th Cir.), 116 F. 2d 971.) The literal meaning of the words of Section 3403(c) of the 1939 Internal Revenue Code are not such as would tax all items used in or on an automobile or motor vehicle, as a part or accessory thereof. Congress intended to tax only those enumerated articles as parts or accessories whether primarily adapted for use as a part or accessory or not and as to all other taxable auto parts or accessories Congress merely said "Parts or accessories (other than tires and inner tubes and other than radio or television receiving sets) for any of the articles enumerated in subsections (A) or (B) . . ." (1939 I. R. C., Sec. 3403(c).)

Baby bottle warmers are not one of those enumerated articles which might be found to be a part or accessory whether primarily adapted for use as a part or accessory or not.

NOR ARE THEY PARTS OR ACCESSORIES FOR ANY OF THE ARTICLES ENUMERATED IN SUBSECTIONS (A) AND (B).

The appellee entirely ignores the facts that appellant's baby bottle warmers are accessories to parents with infant children and are not adaptable to automobile owners as a class. THE STATUTE DOES NOT SET FORTH ANY TEST FOR THE DETERMINATION OF WHAT IS OR IS NOT AN AUTO PART OR ACCESSORY. It is submitted that the test should look to the actual accomplishment of the item involved and the benefit it tenders to the motor vehicle in question.

Here the accomplishment is to warm a baby bottle, certainly this has nothing whatsoever to do with automobiles or motor vehicles. THE MERE FACT THAT ANY ITEM MAY

BE USED IN AN AUTOMOBILE AND USED THERE MORE OFTEN THAN OTHER PLACES IS NOT DECISIVE TO CLASSIFY THE ARTICLE AS AN AUTO PART OR ACCESSORY UNDER THE STATUTE INVOLVED HEREIN. (*McCaughn v. Electric Storage Battery Co.*, 63 F. 2d 715.)

IT IS THE PRIMARY AND CHIEF USE OF THE ARTICLE WHICH ESTABLISHES WHETHER OR NOT IT IS SUBJECT TO THE TAX. (*Perfection Gear Co. v. United States*, 41 F. 2d 561.) Here the primary and chief use of baby bottle warmers is to warm a baby bottle. In fact, it has other uses which they may be put to. BUT NONE OF THE VARIED USES OF BABY BOTTLE WARMERS EVEN REMOTELY HAVE ANYTHING TO DO WITH THE AUTOMOBILE AND THE FUNCTION, UTILITY OR ORNAMENTATION THEREOF.

WHERE DO WE STOP? ARE THERE NO BOUNDARIES FOR THIS STATUTE? COULD CONGRESS POSSIBLY HAVE INTENDED TO TAX EVERYTHING REMOTELY CONNECTED WITH AN AUTOMOBILE?

This writer thinks there must be a boundary and the Treasury Department cannot be permitted to continue to tax any item which in some manner deals with an automobile.

Appellee argues that baby bottle warmers are parts or accessories of automobiles because of the language of Section 3403(c) of the 1939 Internal Revenue Code as interpreted by Treasury Regulation 46.316.55 etc.

Webster defines Chassis as follows: THE FRAMEWORK OF A MOTOR CAR CARRYING THE BODY AND OTHER PARTS. Obviously, therefore, upon examination of Internal Revenue Code, Section 3403(c), it is readily observed that Congress imposed this tax upon Automobile Chassis and

other motor vehicle chassis. (See Subsecs. (A) and (B) thereof.) They did not intend the tax to extend to anything other than the framework or shell of the auto or motor vehicle. Certainly baby bottle warmers as manufactured by appellant have absolutely no connection with the framework or shell of the motor vehicle. How, therefore, can such a tax be imposed upon baby bottle warmers? The only answer is that the tax has been erroneously imposed upon the appellant's baby bottle warmers.

Appellee relies upon the *Universal Battery* case, 281 U. S. 580. (Appellee's Br. p. 9.) In so doing it cites out of context a certain statement made therein. By citing this excerpt out of context it destroys the true implications and intentions of the court when that decision was rendered.

In the first instance, that case was a decision based upon Section 900 of the 1918 Internal Revenue Code. This decision involved many cases of different articles with the same issue, namely, whether the article sold is a part or accessory within the meaning of that Section 900. The court said it must take all three sections of that statute together, and that the words parts or accessories had the same meaning in all the sections, and that the articles involved had the same meaning and relationship to the motor vehicle, AND THAT THEY WERE TAXED AS PARTS OR ACCESSORIES ONLY BECAUSE OF THIS RELATIONSHIP TO THE MOTOR VEHICLE.

We now have to examine what articles the Court had before it when talking about bearing a relationship to the motor vehicle in determining parts or accessories: (1) One of the items involved was storage batteries used in the operation of the auto; (2) Another involved Gears, Flexible shafts and flexible housing all being *replacement*

parts for a speedometer used on motor vehicles; (3) And base brackets and fittings used as replacement parts for bumpers on motor vehicles. So THE COURT IN THE *Universal Battery* case (*supra*) ACTUALLY HAD BEFORE IT PARTS IT CONSIDERED AS REPLACEMENT PARTS OF AN AUTO, and this is what it had in mind when it rendered its decision in the case cited by appellee. If appellant's baby bottle warmers are in some manner a replacement part or accessory of the auto or motor vehicle certainly the excise tax here involved applies, but unquestionably baby bottle warmers are not of that character and to impose the tax as here, is in error.

The Supreme Court's language in that case is important in determining their intention. They said that the scheme of taxation regarding all three sections under the statute center around the motor vehicles enumerated. *Their sale* is the principal thing that is taxed and the sale of parts or accessories for such vehicles is taxed because the part or accessory is within the same field with the vehicles and used to the same ends.

Since appellee contends there has been no change in the statute or the regulation, then the intention of the Supreme Court will only be carried out in taxing those items which bear this relationship the Court was referring to, namely, replacement parts or replacement accessories for motor vehicles.

None of the cases cited by appellee are in point and can each be distinguished on their facts in that they involve articles which bear an immediate relationship to the motor vehicle making it intimately connected thereto. On the other hand, the *Cuno Eng. Corp.* case, 43 F. 2d 259, and *Smith v. McDonald*, 214 F. 2d 920, manifest a clearer picture of the problem before this Honorable Court.

Conclusion.

Appellant's baby bottle warmers are not custom made for a motor vehicle, they are made solely for the convenience of parents with infant children, and not for motorists or motor vehicles as a class.

The findings of the lower court are not clearly supported by the evidence and in fact are based upon a Treasury Regulation which improperly interprets a statute which is clear upon its face.

Taxpayer has advertised these baby bottle warmers as the perfect baby gift and has so advertised them in Parents Magazine receiving thereon the Parents Magazine seal of approval, since appellee has argued that this Honorable Court can hardly be expected to find that the articles were not what taxpayer said they were in his own advertisement (Appellee's Br. p. 10), it is clear that appellee itself feels that baby bottle warmers are a perfect baby gift.

It is difficult to visualize an automobile accessory as a perfect baby gift.

The decision of the District Court is in part incorrect and should be overruled as to that portion of the judgment appealed from.

Respectfully submitted,

ROBERT M. ARAN,

Attorney for Appellant.

No. 15744

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EDGAR ALLAN GALLEGOS and GLORIA GALLEGOS, also
known as ANA GLORIA SASSO VALDIVIESO,

Appellants,

vs.

ALBERT DEL GUERCIO, as District Director for the Los
Angeles District, Immigration and Naturalization Serv-
ice, United States Department of Justice,

Appellee.

BRIEF FOR APPELLEE.

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IN THE

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EDGAR ALLAN GALLEGOS and GLORIA GALLEGOS, also
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Appellants,

vs.

ALBERT DEL GUERCIO, as District Director for the Los
Angeles District, Immigration and Naturalization Service,
United States Department of Justice,

Appellee.

BRIEF FOR APPELLEE.

Jurisdiction.

Appellants, plaintiffs below, sought a review of, and to enjoin enforcement of, final Orders of Deportation based on warrants of arrest [R. 2-6].¹ The District Court entered judgment in favor of appellee [R. 10-15]. The District Court had jurisdiction under Section 10 of

¹References to the typewritten Transcript of Record will be indicated "R." References to appellants' deportation hearings contained in a certified record of the Immigration and Naturalization Service, received in evidence in this action as Exhibit "A" and considered in its original form, will be indicated "Serv. R."; while references to exhibits received in evidence at the deportation hearing will be indicated by "Serv. R. Exh." References to appellants' brief will be indicated by "App. Br."

the Act of June 11, 1946, commonly referred to as the Administrative Procedure Act, 60 Stat. 243, 5 U. S. C., Section 1009 (*Shaughnessy v. Pedreiro*, 349 U. S. 48 (1955)); and its judgment being a final decision, jurisdiction is conferred upon this Court by 28 U. S. C., Section 1291.

Statement of the Case.

The following facts were admitted by the pleadings: That Appellant, Edgar Gallegos, is an alien, a native and citizen of Nicaragua, admitted for permanent residence at El Paso, Texas, on September 18, 1945 [R. 2-6, 7-9]. Appellant Ana Gloria Gallegos is an alien, a native and citizen of El Salvador, admitted for permanent residence at Laredo, Texas, on July 1, 1951 [R. 2-6, 7-9]. On February 17, 1955, warrants of arrest issued by the District Director, Immigration and Naturalization Service, Los Angeles, California, were served on appellants, charging their deportability under Section 241(a) (13) of the Immigration and Nationality Act of 1952 (8 U. S. C., Sec. 1251(a)(13)), in that within five years they knowingly and for gain encouraged, induced, assisted, abetted, or aided another alien to enter the United States in violation of law.

There is no dispute that the Immigration Service Record [Exh. "A" in District Court] reveals the following facts:

Deportation hearings were held on March 3, 1955 [Serv. R. 1-20], August 17, 1955 [Serv. R. 21-81], and August 26, 1955 [Serv. R. 82-137]. On December 28, 1955, the Special Inquiry Officer before whom the hearings were held ruled that the charges in the warrants of arrest were substantiated by the evidence produced at

the hearings and appellants should be deported. From that ruling, appellants appealed to the Board of Immigration Appeals, and on March 23, 1956, the Board of Immigration Appeals ordered the case reopened for the taking of further evidence concerning the "gain" received by appellants in acquiring the alien as their housemaid-babysitter. The Board of Immigration Appeals stated:

"We believe that the record should be clarified as to any gain accruing to the respondents from the illegal entry of Miss Medrano-Represa. We will, therefore, direct a reopening of the proceedings for the purpose of ascertaining what is the standard and minimum wage for like employment as the employment of Miss Medrano-Represa in Los Angeles, California, and vicinity."

On May 10, 1956, and May 31, 1956, hearings were again held before the same Special Inquiry Officer. Reports by two Immigration Service Investigation Officers were introduced into evidence over objection of appellants as Exhibits "6" and "7" to show the prevailing wages of housemaid-babysitters in the Los Angeles area.

On June 6, 1956, the Special Inquiry Officer, based upon the additional facts testified to in the hearings, and based upon Exhibits "6" and "7" (8a and 9 in proceedings against appellant Mrs. Gallegos), ruled that appellants had received "gain" from assisting the alien in her illegal entry. On appeal therefrom, appellants claimed error in the admission of the investigative reports, and claimed insufficiency of evidence to show that appellants either "assisted, induced, etc." the alien in her illegal entry, or that they received any gain from such entry. On August 14, 1956, the Board of Immigration Appeals dismissed that appeal on the ground that appellants' contentions were without support.

It is admitted by the pleadings that a warrant of deportation was thereafter issued against appellants [R. 2-6, 7-9]. Appellants filed complaint in the District Court alleging the following errors: That due process and a fair hearing had been denied by the Special Inquiry Officer by the admission of Exhibits "6" and "7" in the hearings in May, 1956; that a finding of deportability based upon such exhibits was without "reasonable, substantial and probative evidence"; that there was no evidence of "gain"; that at all times appellants denied and continue to deny having knowingly and for gain encouraged or aided in bringing the alien into the United States or aiding her attempt to enter the United States. Appellee's answer denied such allegations. At the trial, the Administrative file—the only exhibit in evidence—was marked Exhibit "A".

The Court below found that there was reasonable, substantial and probative evidence to support the finding that appellants committed the acts charged in the warrants of arrest—*i.e.*, knowingly and for gain assisted the alien in entering illegally; that due process was had in all proceedings; and that the introduction of Exhibits "6" and "7" into evidence did not constitute a denial of due process.

Appellants raise the following issues on appeal:

1. Was there sufficient evidence to show that appellants aided, encouraged, induced, assisted or abetted the alien to enter the United States illegally?
2. If appellants so aided, abetted, etc., did they do so for "gain"?
3. Was due process denied in admitting Exhibits "6" and "7" in the Immigration Hearings because they con-

stituted hearsay evidence, or, as appellant claims, “hearsay upon hearsay”?

4. Did Exhibits “6” and “7” provide any reasonable, substantial and probative evidence upon which to decide that “gain” had accrued to appellants? Was a sufficient foundation laid therefor—*i.e.*, was it shown that the nature of employment considered by those agencies which provide the figures to the investigating officers was “like employment” to the employment of the alien, Hildra Medrano, as required by the Board of Immigration Appeals when it ordered further hearings?

Statutes and Regulations Involved.

Section 241(a)(13) of the Immigration and Nationality Act of 1952, 66 Stat. 204, 8 U. S. C., Section 1251(a)(13), provides in pertinent part:

“Sec. 241(a) Any alien in the United States (including an alien crewman) shall, upon the order of the Attorney General, be deported who—

* * * * *

(13) prior to, or at the time of any entry, or at any time within five years after any entry, shall have, knowingly and for gain, encouraged, induced, assisted, abetted, or aided any other alien to enter or to try to enter the United States in violation of law; . . .”

Section 242(b) of the Immigration and Nationality Act, 66 Stat. 209, 8 U. S. C., Section 1252(b), provides in pertinent part:

“(b) A special inquiry officer shall conduct proceedings under this section to determine the deportability of any alien, and shall administer oaths, present and receive evidence, interrogate, examine, and

cross-examine the alien or witnesses, and, as authorized by the Attorney General, shall make determinations, including orders of deportation. . . . *Proceedings before a special inquiry officer* acting under the provisions of this section *shall be in accordance with such regulations, not inconsistent with this chapter, as the Attorney General shall prescribe.*

Such regulations shall include requirements that—

* * * * *

(3) the alien shall have a reasonable opportunity to examine the evidence against him, to present evidence in his own behalf, and to cross-examine witnesses presented by the Government, and

(4) no decision of deportability shall be valid unless it is based upon reasonable, substantial, and probative evidence.” (Emphasis added.)

Section 242.54(b) of 8 Code of Federal Regulations (Rev. 1952) provides:

“Section 242.54. Contents of record; evidence—

(b) Use of prior statements. The special inquiry officer may enter of record any statement, oral or written, which is material and relevant to any issue in the case, previously made by the respondent or any other person during any investigation, examination or hearing. If objection thereto is made by the alien or his counsel or representative, the reasons for the objection, as well as the ruling thereon by the special inquiry officer, shall be made a part of the record.”

Summary of Argument.

I.

The Finding that appellants are subject to deportation because they knowingly assisted, abetted or aided another alien to enter the United States in violation of law is supported by reasonable, substantial and probative evidence in the form of sworn statements of the alien assisted and of appellant Edgar Gallegos before the Immigration Service investigating officer in February, 1955, admitted in evidence at the deportation hearings. Such evidence clearly shows sufficient facts to constitute "aiding, abetting or assisting" as required by 8 U. S. C., Section 1251(a)(13), under the case of *Navarette-Navarette v. Landon*, 223 F. 2d 234 (C. A. Cal., 1955), cert. den. 351 U. S. 91, 76 S. Ct. 700, 100 L. Ed. 1445.

II.

The Finding that appellants assisted, etc., the alien's illegal entry for purposes of gain is supported by reasonable, substantial and probative evidence, and due process was not denied by the admission of Exhibits 6 and 7, upon which the finding of "gain" was based.

1. The Findings of the Immigration Service and the District Court on review reveal "gain" in the instant case to be the *financial* advantage to appellants in employing the alien Hilda Medrano-Represa as a housemaid-babysitter at substandard wages and in providing relief for Mrs. Gallegos so that she was able to work.

2. The evidence is clear that the alien hired by appellants received only \$20 per month salary plus room and

board. Exhibits 6 and 7 in the proceedings against the appellant husband [Exhs. 8a and 9 in the proceedings against the appellant wife] consisting of investigative reports of wage scales in Los Angeles area established the prevailing wage scale for employment like that of the alien Hilda Medrano-Represa as \$100 per month plus room and board. Therefore, the evidence shows that appellants incurred a financial gain from hiring the alien at substandard wages. In addition, the testimony of Mr. Gallegos in his sworn statement [Serv. R. Exh. 4] reveals that Mrs. Gallegos was able to work because she obtained the alien's services, and therefore the appellants obtained additional benefit from assisting the alien's illegal entry.

3. Due process and fair hearing were not denied appellants by the admission of Exhibits 6 and 7 [Exhs. 8a and 9] in the deportation hearings. Hearsay evidence is admissible in deportation hearings under well-established law. In addition, appellants failed to submit refuting testimony and made no attempt to interview the source of the information contained in such exhibits (*i.e.*, the United States Employment Security Office and the California Department of Labor), although said exhibits revealed the sources. (*United States ex rel. Impastato v. O'Rourke*, 211 F. 2d 609 (C. C. A. Mo., 1954), cert. den. 348 U. S. 827, 75 S. Ct. 47, 99 L. Ed. 652; *Choy Gum v Backus*, 223 Fed. 487, 492-493 (C. C. A. Cal., 1915), cert. den. 239 U. S. 649, 36 S. Ct. 284, 60 L. Ed. 485.)

ARGUMENT.

I.

The Finding That Appellants Are Subject to Deportation Because They Knowingly Assisted, Abetted or Aided Another Alien to Enter the United States in Violation of Law Is Supported by Reasonable, Substantial and Probative Evidence.

A. Evidence Produced at Deportation Hearings Supports This Finding.

Appellants concede that a decision of deportability is valid if supported by "reasonable, substantial and probative evidence." (Sec. 242(b)(4) of the Immigration and Nationality Act, 66 Stat. 210, 8 U. S. C., Sec. 1252 (b) (4); 8 C. F. R. (Rev. 1952, Amd. 1956), Sec. 242.14(a).) However, appellants claim that there is no reasonable, substantial and probative evidence to support the finding of the Special Inquiry Officer and of the Board of Immigration Appeals of the Immigration Service that appellants knowingly assisted, abetted or aided the alien Hilda Medrano-Represa in illegally entering the United States.

The evidence upon which the Special Inquiry Officer found that appellants had assisted Hilda Medrano-Represa in her illegal entry into the United States was in the form of sworn statements before Immigration Service Investigating Officers on February 15, 1955, prior to issuance of the warrants of deportation [Serv. R., Special Inquiry Officer's decision of December 28, 1955, p. 8]. Although these sworn statements were partially repudiated by the witnesses while testifying at the deportation hear-

ings, no attack upon the admission of such statements into evidence was made on appeal to the Board of Immigration Appeals nor during this review proceeding.

The law is well settled that although such sworn statements of the aliens subject to deportation constitute hearsay evidence, they are admissible in deportation hearings not only because they constitute an exception to the hearsay rule where they consist of admissions by the aliens of facts relevant to the aliens' deportability, but also because hearsay evidence is admissible in administrative proceedings. *Schoeps v. Carmichael*, 177 F. 2d 391, 396-397 (C. A. Cal, 1949), cert. den. 339 U. S. 914, 70 S. Ct. 566, 94 L. Ed. 1340, where the Court stated:

"The basic questions in this case are whether the admission of appellant's sworn statements violated standards of fundamental fairness necessary to the validity of the hearing or violated the procedural regulations here applicable and necessary to assure such fairness. This Circuit has uniformly held such statements to be admissible."

See also:

Quattrone v. Niccols, 210 F. 2d 513, 517 (C. A. Mass., 1954), cert. den. 347 U. S. 976, 74 S. Ct. 786, 98 L. Ed. 1116.

The law is also well settled that the sworn statement of the alien Hilda Medrano-Represa was admissible although hearsay evidence, since hearsay evidence is admissible in administrative proceedings in general, and in deportation hearings in particular. (*Hyun v. Landon*, 219 F. 2d 404, 408 (C. A. Cal., 1955), affd. 350 U. S. 990, 76 S. Ct. 541, 100 L. Ed. 856, reh. den. 351 U. S. 928, 76 S. Ct. 777, 100 L. Ed. 1457 and 1458.) However, similarly, appellants have not attacked the admission of Hilda's sworn statement into evidence.

B. The Admissible Sworn Statement of Hilda Medrano-Represa Supports the Finding of Assisting Illegal Entry.

The alien Hilda Medrano-Represa testified to the following facts before an Immigration Service Investigating Officer prior to the issuance of the warrants of arrest on February 15, 1955 [Serv. R. Exh. 5, p. 3 in Appellant Edgar Gallegos' proceedings and Exh. 6, p. 3, in Ana Gloria Gallegos' proceedings. (Note: Exh. 6 is an original and Exh. 5 is a carbon copy of Exh. 6)]: that she had known appellant Mrs. Gallegos for some years, and, in fact, lived at Mrs. Gallegos' house in San Ana, El Salvador; that she contracted with appellant Mrs. Gallegos in January, 1954, to accept employment with Mrs. Gallegos in the United States at \$25 per month; that the Gallegoses paid her plane fare to Tijuana in order to get a visa for her from the American Consul at Tijuana, so that she might enter the United States legally; that they were not able to obtain one immediately, so the Gallegoses left her there and returned to the United States, but visited her each week for eight weeks; that in April, 1954, before any visa was obtained, the lady (with whom Hilda was staying upon the Gallegos' instruction) was not able to keep Hilda any longer and the following testimony was given [Serv. R. Exhs. 5 and 6 above referred to, pp. 4-5]:

“Q. Why did you not remain in Tijuana until you secured your visa and then come into the United States legally? A. Mrs. Ramirez [lady with whom Hilda was staying in Tijuana] became pregnant and wrote to Ana Gloria Gallegos that she couldn't keep me any longer. Mr. and Mrs. Gallegos came to the house in Tijuana and told me that arrangements had been made to take me to the United States. They

were to wait for me in the United States and that I would be brought to them.

Q. Who took you across the line to where the Gallegos were waiting? A. A woman. I did not know her. She met me in the street, and took me to where the Gallegos were waiting. She told me they were waiting near a store for me.

* * * * *

Q. Who was waiting at the car when you arrived? A. Mr. and Mrs. Edgar Gallegos. I got into the car and we came to their residence in Los Angeles."

This testimony standing alone supports the finding that appellants assisted the alien in her illegal entry of the United States. Although Hilda, at the subsequent deportation hearing on August 26, 1955, repudiated her testimony that appellants had arranged to meet her at the border, and testified that the meeting was accidental [Serv. R. pp. 96-119] and that the sworn statement was not accurately reported, the trier of fact, in this instance the Special Inquiry Officer, resolved the conflicting testimony against appellants. The Investigating Officer before whom the statement was made was called and testified to its accuracy [Serv. R. pp. 104-110]. That resolution was solely within the province of the trier of fact and should not be upset on judicial review. Although appellants contend on appeal that Hilda's testimony was confused (App. Br. p. 9, lines 6-11), Hilda's testimony was, in fact, only contradictory. It was the duty of the trier of fact to determine the credibility of Hilda Medrano when testifying during the hearings. (*Morikichi Suwa v. Carr*, 88 F. 2d 119, 121 (C. C. A. Cal., 1937); *Taranto v. Haff*, 88 F. 2d 85 (C. C. A. Cal., 1937).)

In addition to the sworn statement of Hilda Medrano-Represa as evidence against appellants, the Special Inquiry Officer had before him the sworn statement of appellant Edgar Gallegos, which was admitted in evidence in the proceedings against Edgar Gallegos, and which supports the finding that he assisted Hilda's illegal entry into the United States as hereinafter detailed.

C. The Admissible Sworn Statement of Edgar Allan Gallegos Supports the Finding of Assisting Illegal Entry.

Appellant Edgar Gallegos testified before an Immigration Investigating Officer on February 15, 1955, prior to the issuance of the warrants of arrest, to the following facts: That appellants' purpose in bringing Hilda to the United States was to work in their home as a domestic servant [Serv. R. Exh. 4, p. 5]; that appellants left her in Tijuana (as Hilda had testified) while attempting to get her a visa; that a woman called appellants in Los Angeles to have them pick Hilda up on the United States side of the line in April, 1954; the woman promised to make arrangements to get Hilda across the line if appellants would meet her in San Ysidro; that appellants agreed [Serv. R. Exh. 4, pp. 6-7]. Mr. Gallegos testified:

“Q. But you did know that the girl had been illegally brought into the United States that morning, is that true? A. Yes, sir. I had been trying to get her into the United States and we were going to wait for a visa but when we found that we didn't have any other place to leave her—we had been paying this woman to keep her there—we went down and met her and brought her home with us.” [Serv. R. Exh. 4, p. 7.]

He also stated Mrs. Gallegos paid the woman some money [Serv. R. Exh. 4, p. 7] and added:

“Q. Has this girl been with you ever since you brought her to the United States in April, 1954? A. Yes, sir.

* * * * *

Q. Do you admit that you wilfully and knowingly aided this girl in entering the United States, knowing that she was not entitled to enter? A. Yes, it is the truth.” [Serv. R. Exh. 4, p. 8.]

It is obvious that appellant Edgar Gallegos’ testimony, regarding appellants’ assistance in Hilda’s illegal entry, although subsequently repudiated by him at the deportation hearing on March 3, 1955 on the claim that the transcript of this testimony was inaccurate [Serv. R. p. 8], was sufficient alone to warrant the finding of deportability in the proceedings against Mr. Gallegos. However, it need not stand alone, since the Special Inquiry Officer had before him the additional sworn statement of Hilda Medrano-Represa upon which to base his findings of fact. The Special Inquiry Officer called as a witness Immigration Officer Buselle before whom appellant Edgar Gallegos made his sworn statement on February 15, 1955, who testified to the accuracy of the transcript [Serv. R. pp. 72-78].

This evidence clearly supports the finding by the Special Inquiry Officer, affirmed by the Board of Immigration Appeals on March 23, 1956, that appellants aided and assisted Hilda Medrano-Represa in illegally entering the United States. Although appellants did not actually transport Hilda across the border, their acts were held sufficient in *Navarette-Navarette v. Landon*, 223 F. 2d 234, 236 (C. A. Cal., 1955), cert. den. 76 S. Ct. 700, to con-

stitute a violation of the Immigration Act of 1952 in that they “aided, assisted, etc. . . .” an alien’s illegal entry.

Appellants argue on appeal that there is “no dispute that they returned Hilda to Tijuana within a few days of her arrival in April, 1954, but that Hilda returned of her own accord to Los Angeles, without their assistance in January, 1955. Although it is true that Mrs. Gallegos so testified [Serv. R. p. 29], the evidence is clearly in dispute on this point. Hilda Medrano consistently testified that she has continuously remained in the United States since her entry in April, 1954 [see Hilda’s sworn statement, Serv. R. Exhs. 5 and 6, pp. 5-6, and her testimony in deportation hearing, Serv. R. pp. 88-89]. Likewise Edgar Gallegos’ sworn statement [Serv. R. Exh. 4, p. 8] and his testimony at the hearings [Serv. R. p. 12: “Q. Why haven’t you sent the girl Hilda back to Mexico or El Salvador since she entered here in April, 1954? A. Because we thought the Consul was going to give the visa.”] were to the same effect.

II.

The Finding That Appellants Knowingly Assisted, Etc., the Alien Hilda Medrano-Represa’s Illegal Entry for Gain Is Supported by Reasonable, Substantial and Probative Evidence.

A. Findings of Special Inquiry Officer and District Court.

After the first decision of the Special Inquiry Officer on December 28, 1955, appellants appealed to the Board of Immigration Appeals and the Board of Immigration Appeals ordered the hearings reopened, with the following comments:

“We believe that the record should be clarified as to any gain accruing to the respondents from the illegal entry of Miss Medrano-Represa. We will

therefore direct a reopening of the proceedings for the purpose of ascertaining what is the standard and minimum wage for like employment as the employment of Miss Medrano-Represa in Los Angeles, California, and vicinity.”

The hearings were reopened on May 10, 1956. Evidence was given, in the form of two reports by investigating officers, reflecting the results of their inquiries of the United States Employment Service Office and the State of California Department of Labor through Mr. Joseph Levy, Employment Security Officer, regarding the minimum wages of housemaid-babysitters. These reports were marked Exhibits 6 and 7 in the proceedings against Edgar Gallegos and Exhibits 8a and 9 in the proceedings against Ana Gloria Gallegos. Both reflected the minimum wages of such employees to be over \$74 per month plus room and board.

Hilda testified that she had been paid \$20 per month from April, 1954, through January, 1955, but nothing after January, 1955 [Serv. R. pp. 92-93]. Based on Hilda's testimony and Exhibits 6 and 7, the Special Inquiry Officer ruled on June 6, 1956, that appellants had received “gain” from assisting Hilda's illegal entry:

“By having the girl Hilda with the respondents to take care of their minor child, both respondents were able to pursue employment, and, in addition to being able to pursue employment, both respondents secured further gain by paying the girl Hilda Medrano-Represa substandard remuneration.

“Introduced into the record at the reopened hearing . . . on May 10, 1956, were reports of investigation showing that the wage scale for employment such as that engaged in by Miss Medrano-Represa ranged from \$100 to \$200 a month, plus room and board, depending upon the experience of

the employee. As the particular experience of Miss Medrano-Represa is not particularly known, for the purpose of this proceeding it may be considered that she was eligible for the minimum wage scale of \$100 per month, plus room and board."

Although appellants contend that "the direction on remand" was not followed (App. Br. p. 7, lines 20-21), the Board of Immigration Appeals thereafter, on August 14, 1956, dismissed the appeal from the Special Inquiry Officer's finding of *gain*, holding that the evidence during the reopened hearings showed that:

"The wage scale in the Los Angeles, California, area for employment such as was performed by Hilda Medrano-Represa in the home of respondents ranged from \$100 to \$200 a month plus room and board, depending upon the experience of the employee. Hence, it can be seen that Hilda Medrano-Represa was eligible to have received from respondents at least the minimum wage and \$100 per month plus room and board. During the period for which the girl Hilda was employed by the respondents she should have been paid at least \$1600 plus room and board. Moreover, the evidence clearly shows that . . . she received only one month's pay of \$20 for her services between January 1 and August, 1955. The respondents' attempt to justify their failure to pay Hilda the wages due her by claiming that they were put to considerable expense in bringing her to the United States is not pertinent to the issues involved. . . ."

The District Court in its Findings of Fact approved the Immigration Service's holdings, finding that, based on Exhibits 6 and 7, appellants received a monetary gain from hiring Hilda at substandard wages, in addition to the gain of having a housemaid [Finding No. IX, R. 10].

B. Evidence of Reasonable, Substantial and Probative Nature to Support Finding of Gain.

“Gain” is defined by *Webster’s New International Dictionary* (2nd Ed., 1936), page 1025, as “increase or addition to what one has or that which is of profit, advantage, or benefit; resources or advantage acquired; profit.”

Hilda testified at the deportation hearings that her contract with Mrs. Gallegos in San Salvador provided for \$20 per month salary plus room and board; that she received this sum while employed by the Gallegos from April, 1954, through January, 1955, *but that she received nothing from February to August, 1955* [Serv. R. pp. 92-93].

Exhibits 6 and 7 in the proceedings against Mr. Gallegos [Exhs. 8a and 9 in the proceedings against Mrs. Gallegos] were admitted into evidence over appellants’ objection that they constituted hearsay evidence. Assuming for the purpose of argument at this stage that these exhibits were properly admissible, it is clear from the exhibits that the prevailing wages for an inexperienced housemaid-baby-sitter was \$75 to \$150 per month [Exhs. 7 and 9]. Therefore, gain, financially accrued in the savings to appellants by hiring Hilda Medrano-Represa. In addition, Mrs. Gallegos was able to continue working [Serv. R. Exh. 4, p. 8], which constitutes “gain.”

It would appear that the Special Inquiry Officer could have taken judicial notice of the financial gain to appellants even absent Exhibits 6 and 7 [or Exhs. 8a and 9] in view of the great monetary discrepancy between the \$20 per month salary paid Hilda Medrano and the com-

monly known value of labor in the Los Angeles area at any time since World War II. \$20 per month would only be \$5 per week and not even \$1 per day.

Appellants contend that their financial assistance to Hilda in an attempt to obtain a visa prior to her illegal entry should have been taken into consideration in ruling upon the issue of "gain." However, it appears that, as was held by the Board of Immigration Appeals in this case on August 14, 1956, such evidence is irrevelant as to the salary paid Hilda Medrano [Board of Imm. Appeals decision, p. 5].

Appellants complain that there is no showing in Exhibits 6 and 7 that the persons interviewed in obtaining the information reflected in the exhibits knew of the relationship between the alien Hilda Medrano nor of the nature and extent of the services actually rendered by Hilda (App. Br. p. 5, line 21, to p. 6, line 3). However, such a foundation for these exhibits was not necessary. The additional factors of relationship, nature and extent of services rendered were independent facts to be considered by the trier of facts in conjunction with the minimum wage established by Exhibits 6 and 7. No evidence was introduced by appellants showing Hilda's services were substandard.

Although appellants contend that Hilda Medrano-Represa was a "near relative" and that the appellants' acts did not constitute a "commercial venture" (App. Br. p. 6, lines 14 and 24), this was a question of fact for the trier of fact. The Special Inquiry Officer ruled that the facts in this case precluded the belief that respondents were attempting to help a distant relative, since they made no further attempts to obtain Hilda's visa after she entered the United States in April, 1954, and

did not return Hilda to Mexico to pursue her visa application [Serv. R., Inquiry Officer's decision, June 6, 1956, p. 4]. These facts are supported by the testimony of Edgar Gallegos in the deportation hearings [Serv. R. 12-14]. The evidence shows that Hilda was some relative of Mrs. Gallegos, but it is not clear how close [Serv. R. 7, 92, 146; Serv. R. Exh. 4, p. 4; Exh. 5, p. 3].

Mrs. Gallegos claimed at the deportation hearings that she also supplied Hilda with clothes [Serv. R. 183], but Hilda denied such [Serv. R. Exh. 5, p. 5].

An additional circumstance which indicates that appellants aided Hilda's entry into the United States for their own advantage, rather than to aid a relative, is the pattern of conduct indicated by the testimony of Edgar Gallegos in his sworn statement that before Hilda came to the United States, Mrs. Gallegos had a Guatemalan student who was no relation to her, performing the same duties as Hilda for \$10 per week plus room and board [Serv. R. Exh. 4, p. 8].

Therefore, sufficient facts were present in the instant case to support the finding of fact that appellants' motivation was the securing of domestic help at a minimum cost, rather than assisting the alien or her family. Such facts distinguish this case from *In the Matter of G*..... (5 I. & N. S. Dec. 93) and place it in the category of cases covered by *In the Matter of R*..... (2 I. & N. S. Dec. 758), both Administrative decisions.

C. Admissibility of Investigative Reports.

Appellants contend (1) that Exhibits 6 and 7 [Exhs. 8a and 9 in the proceedings against Mrs. Gallegos] were inadmissible under Section 242.11(c) of 8 C. F. R.; (2) that Exhibits 6 and 7 were inadmissible as hearsay;

(3) that due process and a fair hearing were denied by the admission of Exhibits 6 and 7, because the right to cross-examine the individuals supplying the information to the investigating officers was denied by the failure to name them and by the failure to produce them at the hearing or prove that their presence was unobtainable.

(1) Section 242.11(c) of 8 C. F. R. cited by appellants for the contention that Exhibits 6 and 7 should have been sworn to, by its very wording applies only to information obtained during investigations prior to the issuance of a warrant of arrest, to be used to create a *prima facie* case to support the issuance of a warrant of arrest. Section 242.11(a) does not apply to information obtained during subsequent investigations to be used during the deportation hearings and having no connection with the application for warrant of arrest.

(2) Although hearsay evidence is objectionable in judicial proceedings, it is established law that *hearsay evidence is admissible in administrative proceedings*. (*Hyun v. Landon*, 219 F. 2d 404, 408 (C. A. Cal., 1955), *affd.* 350 U. S. 990, 76 S. Ct. 541, 100 L. Ed. 856; *Navarette-Navarette v. Landon*, 223 F. 2d 234, 237 (C. A. Cal., 1955), *cert. den.* 348 U. S. 916, 75 S. Ct. 298, 99 L. Ed. 718, *reh. den.* 75 S. Ct. 437.) Due process is not denied merely because some aspects of a judicial hearing are not followed. "In order to contend that due process has been violated, there must be a substantial denial of justice." (*In the Matter of Couto v. Shaughnessy*, 123 F. Supp. 926, 931 (D. C. N. Y., 1954), *affd.* 218 F. 2d 758 (C. A. N. Y., 1955), *cert. den.* 349 U. S. 952, 75 S. Ct. 879, 99 L. Ed. 1276; *United States ex rel. Bilokumsky v. Tod*, 263 U. S. 149, 157 (1923).)

At the time of the hearings against appellants, the regulation applicable to the introduction of evidence was Section 242.54(b) of 8 Code of Federal Regulations (1952 Rev.) which read as follows:

“(b) Use of prior statements. The Speacial Inquiry Officer may enter of record any statement, oral or written, which is material and relevant to any issue in the case, previously made by the respondent or any other person during any investigation, examination or hearing. If objection thereto is made by the alien or his counsel or representative, the reasons for the objection, as well as the ruling thereon by the Special Inquiry Officer, shall be made a part of the record.”

(Section 242.54(b) was amended in 1956 and is now found in substantially the same form in Sec. 242.14(c):

“(c) Use of prior statements. The Special Inquiry Officer may receive in evidence any oral or written statement which is material and relative to any issue in the case previously made by the respondent or any other person during any investigation, examination, hearing or trial.”)

Therefore, under Section 242.54(b) Exhibits 6 and 7 were admissible, since they constituted a “statement, . . . material and relevant to the case, previously made by . . . any . . . person during any investigation”

(3) In vew of the rule permitting hearsay evidence, and Section 242.54(b) of the Regulations, Exhibits 6 and 7 were properly admitted, unless their admission created an unfair hearing and denied due process. (*Hays v. Zahariades*, 90 F. 2d 3 (C. C. A. Iowa, 1937), cert. den. 302 U. S. 734, 58 S. Ct. 119, 82 L. Ed. 567; *Quattrone v. Nicolls*, 210 F. 2d 513, 516, *supra*.)

Appellants complain that they were unable to cross-examine those persons who furnished the information to the investigators. This objection to evidence is merely the basis of the general hearsay rule. But since the law is well settled that hearsay evidence is admissible in administrative (including deportation) proceedings (*Navarette-Navarette v. Landon, supra*), this objection is of no merit unless it be shown that justice was denied by the Immigration Service's failure to produce such witnesses. However, in this case, no request for the production of such witnesses was made by appellants, who were at all times during the deportation hearings represented by counsel. It was held in *United States ex rel. Impastato v. O'Rourke*, 211 F. 2d 609, 611 (C. C. A. Mo., 1954), cert. den. 348 U. S. 827, 75 S. Ct. 47, 99 L. Ed. 652, that:

"Failure to produce, for cross-examination, witnesses who cannot be found or whose presence cannot be procured or is not requested, does not make a deportation hearing unfair. United States ex rel. Ng Wing v. Brough, supra, page 379 of 15 F. 2d; Quock So Mui v. Nagle, 9 Cir., 11 F. 2d 492, 493; Moncado v. Ramsey, supra, page 196 of 167 F. 2d." (Emphasis supplied.)

Therefore, the failure to produce such witnesses for cross-examination did not render appellants' hearings unfair.

No objection was interposed to the introduction of Exhibits 6 and 7 on the ground that appellants were not given the opportunity of answering them; nor was any request made for an extension of time in which to produce further testimony to refute the same. In fact, appellants offered no evidence to refute the wage scale reflected by Exhibits 6 and 7.

Although appellants claim otherwise, Exhibit 7 revealed the name of the officer in the California Department of Labor who supplied the information. Appellants sought no extension of time in which to bring this officer (Mr. Joseph Levy) before the hearings, nor to produce contrary evidence from the informing offices of the United States Employment Security Office and the California Department of Labor. Appellants' contentions are similar to those made in the case of *Choy Gum v. Backus*, 223 Fed. 487, 492-493 (C. C. A. Cal., 1915), cert. den. 239 U. S. 649, 36 S. Ct. 284, 60 L. Ed. 485, which contentions were overruled in that case by the Ninth Circuit. Therefore, the introduction in evidence of exhibits was not unfair.

Conclusion.

It is respectfully submitted that the judgment of the District Court in favor of appellee, denying the relief prayed for in appellants' Complaint, and affirming the validity of the deportation order, should be affirmed.

Respectfully submitted,

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No. 15,749

IN THE

United States Court of Appeals
For the Ninth Circuit

MARIE GERMAINE ROSE ANNA BISAILLON,
Appellant,

vs.

WILLIAM A. HOGAN, District Director,
Immigration and Naturalization Service,
Honolulu,
Appellee.

On Appeal from the United States District Court
for the District of Hawaii.

APPELLANT'S REPLY BRIEF.

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**On Appeal from the United States District Court
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APPELLANT'S REPLY BRIEF.

This brief is written in reply to appellee's answering brief, a printed copy of which was received through the mail on March 17, 1958. Appellant will not reply herein to the argument of appellee on each and every specification of error but this is not to be construed as a waiver of any specification on which no further argument is offered.

I and II.

THE DISTRICT COURT ERRED IN HOLDING THAT ANY VIOLATION OF SECTION 1542, TITLE 18, U.S.C. INVOLVES MORAL TURPITUDE, AND THAT APPELLANT'S VIOLATIONS OF THAT SECTION INVOLVE MORAL TURPITUDE.

Appellant does not take issue with appellee's statement that "Perjury is a crime involving moral turpitude". (Appellee's brief, p. 3.) In all the cases cited by appellee in support of this proposition the alien was either convicted of perjury or had admitted that he had committed the crime of perjury. We are not concerned in this case with Section 1182(a)(9), Title 8, U.S.C., which makes excludable any alien who admits he has committed a crime involving moral turpitude prior to entry.

The fact of the matter is that Appellant was neither charged with nor convicted of the crime of perjury. That the crime of perjury involves additional elements which must be proved, such as the oath and materiality of the false statement, which are not involved in proof of a violation of Section 1542, Title 18, U.S.C., is abundantly clear. It is also clear that the proof required to establish a perjury violation is more rigorous than the proof required to establish a violation of Section 1542. In this connection it should be noted that a violation of Section 911, Title 18, U.S.C., which provides as follows:

"Whoever falsely and willfully represents himself to be a citizen of the United States shall be fined not more than \$1,000 or imprisoned not more than three years or both,"

involves as much deceit or more deceit than a violation of Section 1542. *Duncan v. United States*, 9th Cir., 1933, 68 F. 2d 136, 143, cert. den. 292 U.S. 646. However, the Board of Immigration Appeals has held that a violation of Section 911 does not involve moral turpitude (*In the Matter of K*, 3 I. & N. 69, note p. 71) as did the Special Hearing Officer in this case.

The significant question then is not whether a violation of Section 1542 is "akin to perjury" but whether fraud is a necessary element of such a violation. The only case cited by the Appellee on this point is *United States ex rel Popoff v. Reimer*, 2 Cir. 1935, 79 F. 2d 513. In that case it was held that the making of a false statement in support of the application of another for naturalization aided the applicant in committing a fraud upon the government and that, therefore, the offense involved moral turpitude. It is submitted that if the *Popoff* case had been decided after the decision in *Bridges v. United States*, 1953, 346 U.S. 209, the Court would not have so held. In the *Popoff* decision the Court equated property frauds with false statements in obtaining rights of citizenship. The Supreme Court in the *Bridges* case has ruled that this equation is not correct. *Bridges v. United States*, *supra* at p. 221.

Appellee argues (Brief p. 6) that *United States v. Shoso Nii*, U.S.D.C. Haw., 1951, 96 F. Supp. 971, "merely narrows the scope of the Wartime Suspension of Limitations Act (18 U.S.C. § 3287) to offenses in which *fraud is named as an element* because of the

policy of repose rather than whether fraud is an actual necessary ingredient to the offense as charged.” In that case the District Court quoted the following language from *United States v. Scharton*, 1932, 285 U.S. 518:

“And as the section has to do with statutory crimes, it is to be liberally interpreted in favor of repose, and ought not to be extended by construction to embrace so-called frauds *not so denominated* by the statutes creating offenses.”

In the *Scharton* case the Court held that a wilful attempt to defeat and evade the payment of income tax did not necessarily involve fraud. In *United States v. Grainger*, 1953, 346 U.S. 235, 243-244, which immediately follows the *Bridges* decision, the defendant relied on the passage quoted above from the *Scharton* case. He had been indicted for a violation of the False Claims Act and the District Court dismissed the indictment on the ground the period of limitations had run. The government appealed contending that the Wartime Suspension of Limitations Act should apply. The Supreme Court reversed stating:

“We believe that Congress sought by its phrase ‘involving fraud . . . in any manner’ to make the Suspension Act applicable to offenses which are fairly identifiable as those in which fraud is an essential ingredient, *by whatever words they are defined*, and that Congress did not seek to limit its applicability to such of those identifiable offenses as also are labeled with a particular symbol.” (Emphasis supplied.)

It appears clear from this language that the Supreme Court in the *Bridges* case directly held that fraud was not an essential element of the crime of making a false statement in a naturalization proceeding, and that the word "fraud" as used in the Wartime Suspension of Limitations Act was given its broadest possible meaning. The Court also stated in the *Grainger* case at page 243:

"The statement of the offenses here carries with it the charge of inducing or attempting to induce *the payment of a claim for money or property involving the element of deceit that is the earmarks of fraud.*" (Emphasis supplied.)

In the light of the foregoing it is respectfully submitted that fraud is no more an essential element of a violation of Section 1542 than it is of a false statement to assist an applicant in gaining the benefits of citizenship.

In determining whether a conviction is based upon a crime involving moral turpitude the Courts

"... must look only to the inherent nature of the crime as defined by law as to the facts charged in the indictment upon which the alien was convicted. The question does not depend upon unnecessary adjectives a zealous prosecutor may have added in the indictment to the essentials required by law nor upon the eloquent description of the offense by the prosecutor to court or jury ..."

"When by its definition the crime does not necessarily involve moral turpitude, the alien can-

not be deported because in the particular instance his conduct was immoral.”

Annotation, 95 L. ed. 899, 902-903.

III.

THE DISTRICT COURT ERRED IN HOLDING THAT APPELLANT'S DEPORTATION HEARING WAS A FAIR HEARING IN THAT SHE WAS DENIED HER RIGHT TO COUNSEL.

At the time of the hearing before the Special Inquiry Officer Appellant was a prisoner confined in Oahu Prison, Honolulu, Territory of Hawaii. Appellee, in arguing that Appellant voluntarily waived her right to counsel, has apparently overlooked some of the following testimony appearing in Exhibit 8:

“p. 6. ‘Q. We are going to proceed with this hearing whether or not Mr. Poston is your attorney,—

A. Well, I mean to say—

Q. —do you understand that?

A. Yes. I understand that if I would have a final action from Mr. Poston, well, then this case would be different.’ ”

“p. 8. ‘Q. You will be given to 1 PM tomorrow to secure counsel. In the event you do not have counsel, the hearing will proceed. Do you understand?

A. If you want we can proceed—you can proceed with the hearing, right now.

Q. You have to say yes or no about counsel. I can't take a half answer. You do not say yes. You do not say no.

A. Okay, I'll say yes.’ ”

It is to be noted that it was unlikely that Appellant could have obtained counsel by 1 p.m. the next day (R. 33, 35-36). After the additional charges, on which Appellant was eventually found deportable, were lodged during the first day of the hearing the Appellant asked for additional time to get an attorney and meet the charges. Appellant requested that the hearing be continued over the following weekend so she could make arrangements to obtain counsel through friends who would visit her on Sunday. This request was denied and the hearing was continued to the following Friday (Ex. 8, pp. 14-15).

Appellee contends that no prejudice resulted from lack of counsel because Appellant's deportability is clear. Appellee forgets that this is a case of first impression and that both parties have had to resort to arguments by analogy to support their respective positions.

IV.

**THE DISTRICT COURT ERRED IN RECEIVING INTO EVIDENCE
THE INFORMATION AND THE INDICTMENT CHARGING AP-
PELLANT WITH VIOLATIONS OF SECTION 1542, TITLE 18,
U.S.C.**

Attention is called to the fact that an appeal is pending from the decision of this Court in *Tseung Chu v. Cornell*, 9th Cir., 1957, 247 F. 2d 929.

CONCLUSION.

For the reasons set forth in Appellant's opening brief and in this brief, it is respectfully submitted that the judgment of the District Court should be reversed.

Dated, Honolulu, T. H.,

March 24, 1958.

HOWARD K. HODDICK,

Attorney for Appellant.

No. 15,749

United States Court of Appeals
For the Ninth Circuit

MARIE GERMAINE ROSE ANNA BISAILLON,
Appellant,

vs.

WILLIAM A. HOGAN, District Director,
Immigration and Naturalization Service,
Honolulu,
Appellee.

APPELLANT'S OPENING BRIEF.

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Attorney for Appellant.

FILED

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U. S. COURT OF APPEALS

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**United States Court of Appeals
For the Ninth Circuit**

MARIE GERMAINE ROSE ANNA BISAILLON,
Appellant,

vs.

WILLIAM A. HOGAN, District Director,
Immigration and Naturalization Service,
Honolulu,
Appellee.

APPELLANT'S OPENING BRIEF.

STATEMENT OF JURISDICTION.

The United States District Court for the District of Hawaii had jurisdiction of the action for declaratory judgment filed therein by Appellant under the provisions of the Act of June 11, 1946, c. 324, Sec. 19, 60 Stat. 243, 5 U.S.C.A. 1009. This Court has jurisdiction of the appeal taken by Appellant from the final judgment dismissing that action under the provisions of Section 1291, Title 28, U.S.C.

STATEMENT OF THE CASE.

Appellant was born in Montreal, Canada, and is a native and citizen of that country (Ex. 8, p. 9;

R. 23). She was first admitted to the United States for permanent residence at St. Albans, Vermont, on December 8, 1947; she departed from the United States sometime after June 23, 1950, and re-entered the United States from Brazil at San Juan, Porto Rico, on August 30, 1950 (Ex. 8, pp. 10-11). She is the owner and manager of a four-unit apartment house in Waikiki, Honolulu, T.H. (Ex. 8, p. 9).

On October 20, 1955, Appellant was convicted of violations of Sections 911 and 1542, Title 18, U.S.C., in the United States District Court for the District of Hawaii in Criminal Case No. 10,982; on December 29, 1955, she was convicted of violations of Sections 911 and 1542, Title 18, U.S.C., in the same Court in Criminal Case No. 10,993 (R. 13; Ex. 8, pp. 11-13; Ex. A, Sub-Ex. 5 and 6*). In No. 10,982, Count I of the Information filed against Appellant, in which she is charged with a violation of Section 1542, alleges in substance that on or about August 16, 1954, she made a false statement in the application of one Florence Paquet for a United States passport in that she stated she was not related to Florence Paquet and that she knew Florence Paquet to be a citizen of the United States (Ex. A, Sub-Ex. 5). In No. 10,993, in Count I of the Indictment returned against Appellant, she is charged with another violation of Section 1542, to-wit: That on or about January 16, 1953, she made a false statement in an application

*"Sub-ex" whenever used in this brief designates the exhibit attached to the original transcript of the deportation hearing contained in Exhibit A.

for a passport that she was born in Laurin, Montana, on October 10, 1919 (Ex. A, Sub-Ex. 6).

Following conviction in No. 10,982, Appellant was sentenced to 18 months in prison (Ex. A, Sub-Ex. 5). Following conviction in No. 10,993, she was sentenced to pay a fine of \$1,000.00 on Count I of the Indictment (Ex. A, Sub-Ex. 6).

While serving the prison term of 18 months imposed as a result of her first conviction she was served at the prison with a warrant of arrest dated January 4, 1956, preliminary to deportation proceedings being commenced against her (R. 19, Ex. 1 a). In the warrant she is charged with being in the United States in violation of its immigration laws in that she had been convicted of a crime involving moral turpitude committed within five (5) years after entry and sentenced to confinement for a year or more (18 U.S.C. 1542), and in that she had been convicted after entry of two crimes involving moral turpitude not arising out of a single scheme of criminal misconduct (18 U.S.C. 1542 and 911), thereby making her deportable under Section 241 (a) (4) of the Immigration and Nationality Act of 1952, 8 U.S.C. 1251 (a) (4).

After receiving this warrant, Appellant promptly retained the services of Elmer E. Poston, a retired district director of the Immigration and Naturalization Service for the District of Hawaii (R. 27, Exhibit 2). Because of his previous employment the service questioned Mr. Poston's right to represent

Appellant in the deportation proceeding and this matter was determined adversely to Appellant by the Board of Immigration Appeals (Ex. 3). Immediately after receipt of this advice, Mr. Poston, by letter dated March 17, 1956, and received by Mr. Hogan, the district director of the Immigration and Naturalization Service on March 19th at 2:21 p.m., advised that he had applied to the board for reconsideration of its decision and requested a continuance of the hearing (R. 77, 79). On March 20, 1956, Mr. Hogan addressed a letter to Appellant at Oahu Prison, where she was incarcerated, advising that her deportation hearing would be held April 9, 1957, and that Mr. Poston was disqualified from representing her (Ex. 3). Appellant was also apprised by Mr. Poston that he was seeking reconsideration of this ruling, and right up to the time it commenced she expected him to represent her at the hearing (Ex. 8, p. 4, R. 35). On March 21, 1956, Mr. Poston addressed a letter to Mr. Finucane, the chairman of the Board of Immigration Appeals, advising that the deportation hearing had been set for April 9, 1956, and requesting expeditious action on his motion for reconsideration; a copy of this letter was sent to the Honolulu office of the Service (R. 79-80). No action was taken on the motion for reconsideration of Mr. Poston's disqualification until April 25, 1956 (R. 80). The deportation hearing was held April 9 and 13, 1956, before Mr. Arnold, special inquiry officer, at the prison, and Mr. Poston was not there nor was Appellant represented by any counsel (Ex. 8).

Exhibit 8, consisting of 20 pages, is a transcript of the proceedings had on April 9 and 13, 1956. It is incomplete as there are 12 occasions when there were "discussion(s) off the record" (Ex. 8, pp. 6, 7, 9, 12, 13, 14, 15, 16, 17, 19). Evidence of the criminal charges presented and of her convictions thereon was received (Ex. 8 pp. 11-13; Ex. A, Sub-Ex. 5 and 6). The major portion of Exhibit 8 is devoted to the matter of her not having counsel and clearly reflects how she was pressured into consenting to proceed with the hearing without counsel. This will be discussed more fully in the argument below. A written "stipulation" offered at the hearing by Appellant was rejected without examination because it had been prepared by Mr. Poston (Ex. 8, pp. 3, 4, 5).

Sometime after the deportation hearing commenced on April 9, 1956, the examining officer lodged two new charges against Appellant, namely, that she was deportable because of her conviction of a violation of Section 1542, Title 8, U.S.C., and sentence of 18 months on that conviction and because of her two convictions of violations of Section 1542, Title 8, U.S.C. (Ex. 8, p. 14). After this new charge was lodged the hearing was continued to April 13, 1956 (Ex. 8, p. 15). On April 13, 1956, the only additional evidence taken was to have Appellant repeat her name and to examine her as to whether she wanted counsel and what attempts she had made to obtain counsel between April 9 and 13, 1956 (Ex. 8, pp. 16-19).

On May 4, 1956, Mr. Hogan addressed a letter to Appellant at the prison enclosing the decision of the special inquiry officer finding her deportable on the charges lodged at the hearing (Ex. 4a and Ex. 4b). In this connection the special inquiry officer ruled that Appellant's violations of Section 1542, Title 18, U.S.C., involved moral turpitude, but that her violation of Section 911, Title 18, U.S.C., did not. From this decision Appellant, through her present counsel, took an appeal to the Board of Immigration Appeals and her appeal was dismissed (R. 42). By letter dated November 21, 1956, and addressed to Appellant at the prison, Mr. Hogan advised her that her appeal had been denied and that she would be taken into custody December 3, 1956, and deported shortly thereafter (Ex. 5).

On November 27, 1956, Appellant filed her complaint in the District Court praying for a judgment declaring her not deportable (R. 3-6). An answer was filed December 4, 1956 (R. 10-12). Appellant completed her term and was released from prison in January, 1957 (R. 81). After hearing, the District Court entered findings of fact and conclusions of law in which it held in part that the grounds of the decision of the special inquiry officer that Appellant was deportable were correct and that she had been afforded a fair hearing and not been denied her right to counsel at the deportation hearing or that, if she was, such denial was not prejudicial (R. 12-16). Judgment was entered dismissing the complaint on June 11, 1957 (R. 16-17). From this judg-

ment this appeal has been duly perfected (R. 17, 18, 120-126).

STATUTES AND REGULATIONS INVOLVED.

Act of June 27, 1952, c. 477, Title II, ch. 5, §241
(a)(4), 66 Stat. 204, 8 U.S.C. 1251(a)(4):

“1251. Deportable aliens—General Classes.

(a) Any alien in the United States (including an alien crewman) shall, upon the order of the Attorney General, be deported who—

(4) is convicted of a crime involving moral turpitude committed within five years after entry and either sentenced to confinement or confined therefor in a prison or corrective institution for a year or more, or who at any time after entry is convicted of two crimes involving moral turpitude, not arising out of a single scheme of criminal misconduct, regardless of whether confined therefor and regardless of whether the convictions were in a single trial.”

Act of June 25, 1948, c. 645, 62 Stat. 771, 18 U.S.C. 1542:

“1542. False statement in application and use of passport.

Whoever willfully and knowingly makes any false statement in an application for passport with intent to induce or secure the issuance of a passport under the authority of the United States, either for his own use or the use of another, contrary to the laws regulating the issuance of passports or the rules prescribed pursuant to such laws; or

Whoever willfully and knowingly uses or attempts to use or furnishes to another for use any passport the issue of which was secured in any way by reason of any false statement—

Shall be fined not more than \$2,000 or imprisoned not more than five years, or both.”

Section 242.15, Title 8, C.F.R.:

“242.15. Contents of record.

The hearing before the special inquiry officer, including the respondent’s pleading, the testimony, the exhibits, the special inquiry officer’s decision, and all written orders, motions, appeals, and other papers filed in the proceeding shall constitute the record in case. The hearing shall be recorded verbatim except for statements made off record with the permission of the special inquiry officer.”

Act. of June 27, 1952, c. 477, Title II, ch. 5, §242, 66 Stat. 208, 8 U.S.C. 1252(b) provides in part as follows:

“(b) A special inquiry officer shall conduct proceedings under this section to determine the deportability of any alien, and shall administer oaths, present and receive evidence, interrogate, examine, and cross-examine the alien or witnesses and, as authorized by the Attorney General, shall make determinations, including orders of deportation. Determination of deportability in any case shall be made only upon a record made in a proceeding before a special inquiry officer, at which the alien shall have reasonable opportunity to be present. * * * Proceedings before a special inquiry officer acting under the provisions of this

section shall be in accordance with such regulations, not inconsistent with this chapter, as the Attorney General shall prescribe. Such regulations shall include requirements that—

(1) the alien shall be given notice, reasonable under all the circumstances, of the nature of the charges against him and of the time and place at which the proceedings will be held;

(2) the alien shall have the privilege of being represented (at no expense to the Government) by such counsel, authorized to practice in such proceedings, as he shall choose;

(3) the alien shall have a reasonable opportunity to examine the evidence against him, to present evidence in his own behalf, and to cross-examine witnesses presented by the Government; and

(4) no decision of deportability shall be valid unless it is based upon reasonable, substantial, and probative evidence.

The procedure so prescribed shall be the sole and exclusive procedure for determining the deportability of an alien under this section. * * *

QUESTIONS PRESENTED.

1. Does any violation of Section 1542, Title 18, U.S.C., necessarily involve moral turpitude?

If the answer to this question is "No," the Appellant is not deportable.

2. Do Appellant's violations of Section 1542, Title 18, U.S.C., involve moral turpitude?

If the answer to this question is "No," the Appellant is not deportable.

3. Was Appellant given a fair hearing on the question of whether she is deportable?

4. Did the special inquiry officer and the District Court err by receiving in evidence the criminal charges preferred against Appellant for the purpose of determining whether her violation of Section 1542, Title 18, U.S.C., involved moral turpitude or not?

SPECIFICATIONS OF ERRORS.

1. The District Court erred in holding that any violation of Section 1542, Title 8, U.S.C., involved moral turpitude.

2. The District Court erred in holding that Appellant's violations of Section 1542, Title 8, U.S.C., involved moral turpitude.

3. The District Court erred in holding that Appellant's deportation hearing was a fair hearing in that

- (a) she was denied her right to counsel; and
- (b) the record of the hearing on which the District Court's finding is based is incomplete.

4. The Court erred in receiving into evidence (Exhibit A) the information and indictment charging Appellant with violation of Section 1542, Title 18, U.S.C., for the purpose of determining whether her violations of that section involved moral turpitude.

ARGUMENT.

I.

THE DISTRICT COURT ERRED IN HOLDING THAT ANY VIOLATION OF SECTION 1542, TITLE 18, U.S.C., INVOLVES MORAL TURPITUDE.

Section 1542 provides as follows:

“Whoever willfully and wrongly makes any false statement in an application for passport with intent to induce or secure the issuance of a passport under the authority of the United States, either for his own use or the use of another, contrary to the laws regulating the issuance of passport or the rules prescribed pursuant to such laws; or

Whoever willfully and wrongly uses or attempts to use, or furnishes to another for use any passport the issue of which was secured in any way by reason of any false statement—

Shall be fined not more than \$2,000.00 or imprisoned not more than five years, or both.”

The District Court approved the findings of the special inquiry officer that Appellant is deportable because she had been convicted of a crime (Section 1542, Title 18, U.S.C.) involving moral turpitude committed within five years after entry, and confined therefor more than one year, and because after entry she had been convicted of two crimes (both of them Section 1542, Title 18, U.S.C.) involving moral turpitude and not arising out of a single scheme of criminal misconduct.

The question of whether a crime involves moral turpitude is to be determined in the light of how

such crime is regarded by the community or the average man, not by how an ideal citizen would feel about such crime. *United States ex rel Iorio v. Day*, 2d Cir., 1929, 34 F.2d 920.

To involve moral turpitude, the act or acts which constitute the crime must evidence baseness, vileness or depravity of moral character. *United States ex rel Mylius v. Uhl*, S.D.N.Y., 1913, 203 F. 152, 154 aff'd 2d Cir., 1914, 210 F. 860; *United States ex rel Meyer v. Day*, 2d Cir., 1931, 54 F.2d 336; *United States v. Carrollo*, W.D. Mo., 1939, 30 F. Supp. 3, 7; *United States ex rel Manzella v. Zimmerman*, E. D. Pa. 1947, 71 F. Supp. 534; *United States ex rel Teper v. Miller*, S.D.N.Y., 87 F. Supp. 285; *Pino v. Nicolls*, D.C. Mass., 1954, 119 F. Supp. 122, aff'd 215 F.2d 237, rev'd on other grounds 349 U.S. 901; *Vidal Y. Planas v. Landon*, S.D. Calif., 1952, 104 F. Supp. 384; *In the Matter of B*, 6 I. & N. Dec. 98, 106.

As was stated in *In the Matter of B* at page 107:

"One of the criteria adopted to ascertain whether a particular crime involves moral turpitude is that it be accompanied by a vicious motive or corrupt mind."

In the *Carrollo* case, in which the question of whether the attempted evasion of taxes involved moral turpitude was at issue, the Court stated:

"We are not prepared to rule that an attempt to evade the payment of a tax due the nation or the commonwealth, or the city, or the school district, wrong as it is, unlawful as it is, is an act evidencing baseness, vileness or depravity of

moral character. The number of men who have at some time sought to evade the payment of tax to some taxing authority is legion. Any man who does that should be punished civilly or by criminal sentence, but to say that he is base or vile or depraved is to misuse the words.”

A crime does not involve moral turpitude if before it was made punishable as a crime it was not generally regarded as morally wrong, or as offensive to the moral sense of the community. *Coykendall v. Skrmetta*, 5th Cir., 1927, 22 F.2d 120; *In the Matter of R*, 6 I. & N. Dec. 440, 452.

The test of whether the crimes of which Appellant was convicted involve moral turpitude does not lie in the acts which she did, but rather, in whether any act or combination of acts, which would constitute an offense under the statute defining the crime, inherently or necessarily involve moral turpitude.

In the Matter of R, 6 I. & N. 444, at page 448, the Board of Immigration Appeals held that:

“If, on the other hand, we find that the law punishes acts which do not involve moral turpitude, then we *must* rule that *no* conviction under that law involves moral turpitude, although in the particular instance conduct was immoral. (*United States ex rel Robinson v. Day, supra*).”

To the same effect see: *United States ex rel Mylius v. Uhl, supra*; *United States ex rel Manzella v. Zimmerman, supra* at p. 538; *United States ex rel Guarino v. Uhl*, 2d Cir., 1939, 107 F.2d 399; *In the Matter of E*, 2 I. & N. 134, 145; *United States v. Carrollo, supra*.

In cases not involving violence the Courts sometimes have determined whether moral turpitude is involved by whether fraud is or is not an essential element of the offense. *United States ex rel de George v. Jordan*, 341 U.S. 223 (1951); *United States ex rel Berlandi v. Reimer et al.*, S.D.N.Y. 1939, 30 F. Supp. 767, aff'd 113 F.2d 429; *Ponzi v. Ward*, D. C. Mass., 1934, 7 F. Supp. 736.

It must be apparent that an applicant for a United States passport could commit a violation of Section 1542 by giving false information as to the date of his birth, the place where he was born, his occupation, his address, the name of his wife and/or many other things called for in the application. If done knowingly, he should be punished, but as was stated in the *Carrollo* case, *supra*, "To say that he is base, or vile, or depraved is to misuse words." Under the principles set out above, the Court cannot look at the evidence to see whether such an applicant had a criminal intent at the time he made the false statement; he may have done it because he was embarrassed about his age or the town in which he was born or lived, or because his wife was insane, or simply because he considered himself a "rugged individualist" and that the information requested was none of the Government's business. Also, even if he were to tell the truth he might still be entitled to a passport.

In fact, it is Appellant's contention that even if the violation of Section 1542 consists of making a false statement without which the passport would

not have been issued, such as a false claim to American citizenship, such a violation is not fraudulent.

Bridges v. United States, 346 U.S. 209 (1953), involves the question of whether the period of limitations had tolled in connection with making a false material statement under oath in a naturalization proceeding (Section 1015, Title 18, U.S.C.). The United States took the position that it came under a special extended period of limitations created by the Wartime Suspension of Limitations Act (Section 3287, Title 18, U.S.C.) relating to the commission of frauds against the Government. The Court found that fraud was not an essential ingredient of the offense and that accordingly that Section 3287 did not apply. Certainly the gain of citizenship is more valuable to the offender than the gain of a passport.

In *United States v. Shoso Nii*, D.C. Hawaii 1951, 96 F. Supp. 971, the defendant was charged with a violation of Section 220, Title 22, U.S.C., 1940 ed., from which Section 1542 is derived. Here again the Government had to rely on the Wartime Suspension of Limitations Act, but the District Court dismissed the indictment on the ground that no fraud was involved. The Government later on its own motion dismissed the appeal it had taken from that decision (342 U.S. 912).

A deportation statute is to be construed in the light most favorable to the alien. *Delgadillo v. Carmichael*, 332 U.S. 388 (1947). When this is done in the instant case, it is apparent that the minimum acts required for a violation of Section 1542, Title

18, U.S.C., do not involve moral turpitude any more than does an unlawful escape (*United States ex rel Manzella v. Zimmerman, supra*), and far less than an attempt to evade taxes does. (*United States v. Carrollo, supra*).

II.

THE DISTRICT COURT ERRED IN HOLDING THAT APPELLANT'S VIOLATIONS OF SECTION 1542, TITLE 18, U.S.C., INVOLVED MORAL TURPITUDE.

It was the position of both the District Court and the special inquiry officer that the charges presented against Appellant and the judgments convicting her on those charges could be examined to determine whether the offenses involved moral turpitude.

In Cr. No. 10,982 in Count I, Appellant is charged with having on or about August 16, 1954, falsely stated in the application of Florence Paquet that she was not related to Florence Paquet and that she knew Florence Paquet to be a citizen of the United States with the intention to induce the issuance of a passport to Florence Paquet. In Criminal No. 10,993 in Count I, Appellant is charged with having falsely stated on or about January 16, 1953, that she was born in Laurin, Montana, on October 10, 1919, with the intention to induce the issuance of a passport to herself. In substance the judgments of conviction reiterate the charges (Ex. A, Sub-Ex. 5 and 6).

“ . . . a crime involves moral turpitude when its nature is such that it manifests upon the part of its perpetrator personal depravity or base-

ness.” *United States ex rel Mylius v. Uhl*, *supra*.

In the Matter of E, 2 I. & N. 134, the Board of Immigration Appeals quoting from *United States ex rel Mylius v. Uhl* states:

“Neither the immigration officials, nor we, may consider the circumstances under which the crime was in fact committed. When by its definition it does not *necessarily* involve moral turpitude, the alien cannot be deported because in the particular instance his crime was immoral * * *. Conversely, when it does, no evidence is competent that he was in fact blameless (*United States ex rel Robinson v. Day*, 51 F. (2d) 1022 (C.C.A. 2d 1931).

“It is the moral obliquity of the crime and not of the individual. That is the test under the law. * * *”

Assuming, for purposes of argument only, that the action of the special inquiry officer and of the Court, in looking at the charges and the judgments to determine whether the offenses involved moral turpitude, their interpretation of this phrase should have been liberal and the benefit of any doubtful meaning which it may have should have been given to Appellant.

“We resolve the doubts in favor of that construction (a liberal construction) because deportation is a drastic measure and at times is the equivalent of banishment or exile. *Delgadillo v. Carmichael*, 332 U.S. 388. It is the forfeiture for misconduct of a residence of this country.

Such a forfeiture is a penalty. To construe this statutory provision law generously to the alien might find support in logic. But since the stakes are considerable for the individual, we will not assume that Congress meant to trench on his freedom beyond that which is required by the narrowest of several possible meanings of the word used." *Fong Haw Tan v. Phelan*, 333 U.S. 6, 10.

Though evidence *aliunde* is not to be considered, the passports obtained were used simply to go to Guam rather than to claim the rights of an American citizen in a foreign land, and a passport to enter Guam is needed only because the Navy requires it.

It is respectfully submitted that the acts alleged in the charges and the facts stated in the judgments of conviction do not constitute "crimes which shock the public conscience, such as crimes of violence, or crimes revealing inherent baseness, vileness or depravity." *United States v. Jordan*, 7th Cir., 1950, 183 F.2d 768.

III.

THE DISTRICT COURT ERRED IN HOLDING THAT APPELLANT'S DEPORTATION HEARING WAS A FAIR HEARING IN THAT (a) SHE WAS DENIED HER RIGHT TO COUNSEL; AND THE RECORD OF THE HEARING ON WHICH THE DISTRICT COURT'S FINDING IS BASED IS INCOMPLETE.

(a) Denial of right to counsel.

Section 1252(b), Title 8, U.S.C., provides in part that at a deportation hearing the alien shall have the privilege of being represented by counsel of his choice. Appellant had selected a competent qualified

counsel who had formerly been a district director with the Immigration Service. The Board of Immigration Appeals ruled that he was disqualified; he applied for reconsideration and on March 19, 1956, Mr. Hogan, the district director in Honolulu was advised of this. The next day Mr. Hogan ordered the matter of Appellant's deportation set down for hearing on April 9, 1956. His excuse for this was that he wanted the matter disposed of before Appellant became eligible for parole in May (R. 81). Appellant's counsel requested that his application for reconsideration be expedited, but no decision was made until April 25, 1956, twelve days after the deportation hearing had been concluded (R. 79-80). Appellant was not released until January of 1957. Even if Appellant had obtained an unconditional parole in May the service must have known that her status could not be finally settled by them as she always had the right to appeal to the Board of Immigration Appeals.

A reading of the transcript of the deportation hearing clearly reflects that Appellant insisted on being represented by counsel of her choice, but that when she saw they were going ahead with the hearing anyway she gave in and consented to their proceeding (Ex. 8). The hearing commenced on a Monday, and when it became necessary to continue it because of the new charges being filed by the examining officer even her request that it be continued over the following weekend so she could consult with friends or her cousin about getting other counsel was denied (R. 105, Ex. 8, p. 15).

The District Court held that even if this constituted a denial of Appellant's right to counsel it was not prejudicial because the facts were undisputed (R. 15). There was, however, a serious question of law involved and it is submitted that Appellant was entitled to have that presented to the special inquiry officer through counsel of her choice. It is no answer to say that she was subsequently represented by counsel before the Board of Immigration Appeals and the District Court. With competent counsel the matter might never have had to go beyond the first stage. Objections could have been made to the introduction of evidence and her record on this score preserved. All relevant and material portions of the hearing would have been recorded instead of having so many instances of discussion(s) "off the record."

It is Appellant's contention that having been denied her right to counsel she was not afforded a fair hearing. *Handlovits v. Adcock*, E. D. Mich. 1948, 80 F. Supp. 425.

In *Bridges v. Wixon*, 326 U.S. 135, 153 (1955), the Court stated:

"It was assumed in *Bilokumsky v. Tod*, 263 U.S. 149, 155, that 'one under investigation with a view to deportation is legally entitled to insist upon the observance of rules promulgated by the Secretary pursuant to law.' We adhere to that principle."

and at page 154:

"That deportation is a penalty—at times a most serious one—cannot be doubted. Meticulous

care must be exercised lest the procedures by which he is deprived of that liberty not meet the essential standards of fairness.”

As was held in the *Handlovits* case, “It is not compliance with requirements of a fair hearing to say that she would be subject to deportation in any event.”

(b) Incomplete record.

As stated in Section 1252(b), Title 8, U.S.C., *supra* p. 6: “Determination of deportability in any case may be made only upon a record made in a proceeding before a special inquiry officer.” Section 242.15, Title 8, C.F.R., provides that “The hearing shall be recorded verbatim except for statements made off the record with the permission of the special inquiry officer.” However, a record of 20 pages containing 12 discussion(s) “off the record,” many of which pertained to the important question of whether Appellant was to be represented by counsel, does not constitute the type of record required under §1252(b), Title 8, U.S.C., nor does it provide the type of record capable of review in a proceeding under the Administrative Procedure Act, Section 1009, Title 5, U.S.C. *Isbrandtsen Co. v. United States*, D.C.N.Y. 1951, 96 F. Supp. 883, *aff’d* 342 U.S. 950.

It is to be noted that none of the testimony was placed “off the record” at the request of Appellant, that was usually done “at the suggestion of the special inquiry officer” (R. 101-102). In *United States ex rel Bauer v. Shaughnessy*, S.D.N.Y., 1949,

115 F. Supp. 780, 784, cert. den. 332 U.S. 839, the Court approved the use of off the record discussions on the ground that no objections to this procedure had been voiced by the alien, but in that case the alien was a patent attorney.

“ . . . where, a board or commission is required to base its actions on findings to be made after a hearing, a definite record must be made of all evidence produced before the Commission and all matters upon which it bases its order. The function of the court to prevent abuse of power by administrative officers can be fulfilled only when a full record is preserved of the essentials on which the officers proceed to judgment. A failure to make and preserve such a record for the purposes of administrative as well as judicial review may constitute a denial of a fair hearing.”
42 Am. Jur. 390.

In *Kwock Jan Fat v. White*, 253 U. S. (1920), the Court reviewed the adequacy of a record of an exclusion hearing. The Court held at page 464:

“It is the province of the courts, in proceedings for review, within the limits amply defined in the cases cited to prevent abuse of this extraordinary power, and this is possible only when a *full* record is preserved of the essentials on which the executive officers proceed to judgment. For failure to preserve such a record for the information, not less of the Commissioner of Immigration and of the Secretary of Labor than of the courts, the judgment in this case must be reversed.” (Emphasis supplied.)

IV.

THE DISTRICT COURT ERRED IN RECEIVING INTO EVIDENCE
THE INFORMATION AND THE INDICTMENT CHARGING AP-
PELLANT WITH VIOLATIONS OF SECTION 1542, TITLE 18,
U.S.C.

As argued in assignment of error I above, it is Appellant's position that the Court and the special inquiry officer should have looked no further than the statute under which Appellant was charged and convicted.

It has recently been settled by this Court in *Tseung Chu v. Cornell*, 9th Cir., 1957, 247 F.2d 929, 936, that the record of conviction includes the indictment, plea, verdict and sentence, and this assignment is made to preserve Appellant's record on this point.

To examine the charge (Ex. A, Sub-Ex. 5 and 6) is contrary to the line of cases which hold that if any offense under the statute might not involve moral turpitude that then the alien's particular violation does not necessarily or inherently involve moral turpitude.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the judgment of the District Court should be reversed.

Dated, Honolulu, T. H.,
February 18, 1958.

HOWARD K. HODDICK,
Attorney for Appellant.

No. 15,749

IN THE

United States Court of Appeals
For the Ninth Circuit

MARIE GERMAINE ROSE ANNA BISAILLON,
Appellanti,

vs.

WILLIAM A. HOGAN, District Director,
Immigration and Naturalization Service,
Honolulu,
Appellee.

On Appeal from the United States District Court
for the District of Hawaii.

APPELLEE'S BRIEF.

LOUIS B. BLISSARD,
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No. 15,749

United States Court of Appeals For the Ninth Circuit

MARIE GERMAINE ROSE ANNA BISAILLON,
Appellant,

vs.

WILLIAM A. HOGAN, District Director,
Immigration and Naturalization Service,
Honolulu,
Appellee.

On Appeal from the United States District Court
for the District of Hawaii.

APPELLEE'S BRIEF.

Appellee agrees with Appellant's statement of jurisdiction and statement of the case with a few minor reservations. The only disagreement would be with Appellant's argumentative statement concerning the contents of Exhibit 8 (Appellant's Br., p. 5).

QUESTIONS PRESENTED.

1. Were the convictions of the crimes for which Appellant was deported convictions of crimes involving moral turpitude?
2. Was Appellant given a fair hearing?

SUMMARY OF ARGUMENT.

Appellant's two crimes both involve moral turpitude. They both involve fraud and are akin to perjury. Appellant's hearing was a fair hearing in that she waived her statutory right to counsel (8 USC § 1252(b)(2)). Her stubborn insistence on disqualified counsel avails her nothing when the record shows she was apprised of his disqualification by the Board of Immigration Appeals (Ex. 8; Ex. A). No prejudice resulted to Appellee's case from her failure to select anyone but a disqualified attorney.

ARGUMENT.

I.

SECTION 1542, TITLE 18, UNITED STATES CODE, INVOLVES MORAL TURPITUDE.

The section provides *in part* as follows:

Whoever *willfully and knowingly makes any false statement* in an application for a passport *with intent to induce and secure the issuance of a passport* under the authority of the United States, either for his own use or the use of another *contrary to the laws regulating the issuance of passports* or the rules prescribed pursuant to such laws, * * *. (Emphasis added).

To begin with, the portion of the statute above cited is the portion under which Appellant was charged. (Ex. 8, pp. 11-13; Ex. A, sub ex 5 and 6*).

*For the purpose of clarity and continuity, the designation "Sub ex" carries the same connotation as in Appellant's Brief (Brief 2 note *).

This particular portion of the statute is akin to perjury. Perjury is a crime involving moral turpitude. *Kaneda v. U.S.*, 9 Cir. 1922, 278 Fed. 694; *Masaichi Ono v. Carr*, 9 Cir. 1932, 56 F.(2d) 772, 774; *U.S. v. Schlotfeldt*, 7 Cir. 1940, 109 F.(2d) 106; *U.S. v. Karnuth*, DC WDNY 1933, 2 F.Supp. 998, c.f. *U.S. v. Uhl*, 2 Cir. 1934, 70 F.(2d) 792, cert. denied 293 U.S. 573, 55 S.Ct. 85. However, describing the offense as set out in the statute with particular emphasis on the fraud aspects of the statute, we are reduced to the simple problem: is fraud an essential element of the offense? The Appellee's contention is that it is fraud. The attention of this Court is drawn to the reasoning of the Court in *U.S. ex rel Popoff v. Reimer*, 2 Cir. 1935, 79 F.(2d) 513, 515.

The statute creates two crimes: (1) Knowingly aiding a person not entitled thereto to apply for or secure naturalization or to file preliminary papers; and (2) in such a proceeding knowingly procuring or giving false testimony or a false affidavit. The judgment of conviction shows that the former offense was the one committed, and that the appellant aided the applicant by making false statements regarding the applicant's name and entry. We may not assume that the false statements were made under oath; and without an oath there can be no perjury. Were perjury charged, there could be no doubt that the crime involved moral turpitude. *United States ex rel. Karpay v. Uhl*, 70 F. (2d) 792 (C.C.A.2). Although the appellant's crime did not involve perjury, it necessarily involved aiding the applicant to commit a fraud upon the government and giving such aid knowingly. Criminal frauds with respect to property

have universally, so far as we are advised, been deemed to involve moral turpitude. *United States ex rel. Medich v. Burmaster*, 24 F.(2d) 57 (C.C.A.8); *United States ex rel. Millard v. Tuttle*, 46 F.(2d) 342 (D.C. La.); *Ponzi v. Ward*, 7 F. Supp. 736 (D.C. Mass.). That the fraud relates to obtaining rights of citizenship rather than to property does not, we think, make it any the less contrary to community standards of honesty and good morals. In our opinion the inherent nature of the offense of fraudulently aiding an alien not entitled to naturalization to apply for or obtain citizenship involves the moral turpitude requisite for deportation. Compare *In re O'Connell*, 184 Cal. 584, 194 P. 1010; *In re Hofstede*, 31 Idaho, 448, 173 P. 1087; *In re Peters*, 73 Mont. 284, 235 P. 772.

Although the statute here involved is not the same, it is nevertheless quite parallel—the statute charges an obvious fraud against the United States. “* * * It can be concluded that fraud has consistently been regarded as such a contaminating component in any crime that American Courts have, without exception, included such crimes within the scope of moral turpitude.” *Jordan v. DeGeorge*, 1951, 341 U.S. 223, 229.

This Court, as Appellant is forced to concede, has settled one issue involved herein: That is, that the Immigration officials and the reviewing Court may examine the record of conviction; that is, the charge (indictment); plea, verdict, and sentence because “it is the specific criminal charge of which the alien was found guilty and for which he is sentenced that conditions his deportation, provided it involves moral tur-

pitude. * * *'' Quoted from *U.S. ex rel Zoffarano v. Corsi*, 2 Cir. 1933, 63 F.(2d) 757, 759, with approval. *Tseung Chu v. Cornell*, 9 Cir. 1957, 247 F.(2d) 929, 936.

Appellant contends further, *Tseung Chu v. Cornell*, *supra*, also settles the issue presented in Appellant's argument I (Br. 11-16), in that Appellant's argument seems to be that where any portion of the statute does not involve moral turpitude (which is not conceded by Appellee), then you may look no further than the statute. The argument is then that if any possible offense under the statute does not involve moral turpitude the reviewing Court's work is done. This quite apparently is not the holding in *Tseung Chu v. Cornell*, *supra*, since there would be no reason to look at the record of conviction if this were true. See also *U.S. ex rel Zoffarano v. Corsi*, 2 Cir. 1933, 63 F.(2d) 757, 759; *U.S. ex rel Giglio v. Neeley*, 7 Cir. 1953, 208 F.(2d) 327; *U.S. ex rel Berlandi v. Reimer*, 2 Cir. 1940, 113 F.(2d) 429; *U.S. ex rel Guarino v. Uhl*, 2 Cir. 1939, 107 F.(2d) 399, 400; *U.S. ex rel Popoff v. Reimer*, 2 Cir. 1935, 79 F.(2d) 513 (Appellant's Br. 23).

However, one argument made in Appellant's Brief concerning whether the statute involved fraud should be answered (Appellant's Br. 15). Appellant cites *Bridges v. U.S.*, 346 U.S. 209 (1953) as an analogous case showing that fraud is not a necessary element of the offense therein considered (18 USC § 1015). The Court states at page 222, " * * * The offense there charged is that Bridges knowingly made a false ma-

terial statement in a naturalization proceeding. In that offense, as in the *comparable offense of perjury*, fraud is not an essential ingredient. The offense is complete without proof of fraud, although fraud often accompanies it. * * *” (Emphasis supplied). Appellee has contended that this offense is comparable to perjury—a crime involving moral turpitude. Secondly, it will be noted that to constitute an offense this statute requires the additional element, “* * * with intent to induce and secure the issuance of a passport * * * contrary to the laws regulating the issuance of passports or the rules prescribed pursuant to such laws.” (In part 18 USC § 1542). The completed offense requires more than false statements alone. Appellee contends that the additional elements make fraud a necessary part of the offense which makes the offense one involving moral turpitude. *Jordan v. De-George, supra*. Further, in *Bridges v. U.S., supra*, pages 220-221, the Court held the Wartime Suspension of Limitations Act (18 USC § 3287) covers offenses defrauding the United States in a pecuniary manner and hence would not concern this type of fraud at any rate.

Further, *U.S. v. Shoso Nii*, 96 F.Supp. 973, merely narrows the scope of the Wartime Suspension of Limitations Act (18 USC § 3287) to offenses in which *fraud is named as an element*—because of the policy of repose rather than whether fraud is an actual necessary ingredient to the offense as charged. Compare *U.S. ex rel Popoff v. Reimer*, 79 F.(2d) 513, 515. *Tseung Chu v. Cornell*, 249 F.(2d) 929, 936, note 6.

Appellant^{see} contends that the thorough discussion of moral turpitude contained in *Tseung Chu v. Cornell*, *supra*, covers the field and it is our contention that the specific violations with which Appellant was charged and convicted plainly involved moral turpitude.

II.

APPELLANT RECEIVED A FAIR HEARING.

Appellant's contentions concerning the hearing are twofold. "(A) She was denied her right to counsel (B) and the Record of the hearing on which the District Court's Finding is based is incomplete." (Appellant's Br., p. 18).

(A) Denial of counsel.

Appellant has a privilege of being represented by counsel of her choice, authorized to practice before the Immigration Service at no expense to the Government. (8 USC § 1252(b) (Appellant's Br. 8-9).

But also the Appellant has the right or privilege to proceed without counsel. Appellant has made two statements with which Appellee takes issue. They are as follows: "The major portion of Exhibit 8 is devoted to the matter of her not having counsel and clearly reflects how she was pressured into consenting to proceed with the hearing without counsel." (Appellant's Br., p. 5). And, "A reading of the transcript of the deportation hearing clearly reflects that Appel-

lant insisted on being represented by counsel of her choice, but that when she saw they were going ahead with the hearing anyway, she gave in and consented to their proceeding." (Appellant's Br., p. 19). The discussion in Exhibit 8 concerning an attorney, and particularly, concerning Mr. Poston, begins on page 3 thereof, and it is very clear that for one reason or another the Board of Immigration Appeals had decided that Poston was disqualified from participating in the proceeding (Ex. 8, p. 4; Ex. A, sub ex 1). It was also clear that Appellant understood this. (Ex. 8, p. 4.) Further, if there was any doubt as to what Appellant had been advised by Poston, the evidence was always available to the Appellant, although not likewise available to the Appellee because of the attorney-client privilege. Indeed Poston himself was present in Court during the hearing and before Appellant had rested. (R. 58.) An examination of Ex. 8, pp. 6-7 will show that the Special Inquiry Officer was in the process of determining how long a time Appellant would need to secure another attorney when she volunteered the statement, "I'm ready to go ahead with the hearing if you want to." (Ex. 8, p. 7.) Thereafter the only possible pressure applied to Appellant was to make a decision—did she or did she not want to proceed without counsel. (Ex. 8, pp. 7-8.) She did consent to go on without counsel. (Ex. 8, p. 8).

Further, at the conclusion of the first day of hearing, additional charges were lodged (Ex. 8, p. 14), and Appellant stated she wished to get *an attorney* and have time to meet the charges. (Ex. 8, p. 14.)

At the continued hearing (Ex. 8, pp. 16-19) Appellant stated first she had no attorney so far (Ex. 8, p. 16.) Then, that she was waiting for a communication from Poston. (Ex. 8, p. 16.) When queried whether she would like to talk with Poston on the telephone (Ex. 8, p. 17), it was also developed that she had called Poston after the first day of hearing and had as of that time received no answer. (Ex. 8, pp. 17-18.) She was allowed to call him again. (Ex. 8, p. 18.) She then again consented to proceed without counsel. (Ex. 8, p. 18.) Appellant contends that this amounts to no more than a waiver of her statutory privilege to counsel of her own choice at her own expense.

Further, Appellant's deportability is clear. In this case no prejudice resulted from lack of counsel. There was nothing counsel could do nor anything witness could supply which would change the result of the proceeding. *Sumio Madokoro v. DelGuercio*, 9 Cir. 1947, 100 F.(2d) 164, 167; *U.S. v. Heikkinen*, 240 F.(2d) 94, 98, cert. granted, 353 U.S. 935, 77 S.Ct. 813, 1 L.Ed. (2d) 758, but not on grounds of lack of representation by counsel at the deportation hearing, 25 L.W. 3305. See also *Melha v. Shaughnessy*, 2 Cir. 1955, 219 F.(2d) 600, *In the Matter of the Application of Pietro Biagio Raimonde for a Writ of Habeas Corpus* (USDC ND Cal., S.Div.) Decided Nov. 5, 1954, Civil 34114 (unreported). "Failure to have counsel, if error, like other errors, may not be prejudicial." *Madokoro v. DelGuercio*, *supra*, p. 167.

(B) Incomplete record.

The record of the deportation hearing contains "off the record discussions." This procedure is allowed (8 C.F.R. 242.15), consequently, off the record discussions do not make incomplete records. For the substance of the off the record discussions see the testimony of George L. Elms (R. 85-100). Further, the Immigration and Nationality Act expressly supersedes the hearing provisions of the Administrative Procedures Act—*Marcello v. Bonds*, 349 U.S. 302, 305-311.

CONCLUSION.

The Appellant had a fair hearing in a case of clear deportability. The convictions of the crimes for which she was ordered deported show that they are crimes involving moral turpitude.

Dated, Honolulu, T.H.,
March 11, 1958.

Respectfully submitted,

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No. 15752

United States
Court of Appeals
for the Ninth Circuit

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court
of the United States

FILED

DEC 20 1957

PAUL P. GIBLIN, CLERK

No. 15752

United States
Court of Appeals
for the Ninth Circuit

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court
of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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Chief Counsel, Internal Revenue Service,
Washington, D. C.,
For Respondent.

In the Tax Court of the United States

Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1955

Jan. 28—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 31—Copy of petition served on General Counsel.

Jan. 28—Request for Circuit hearing in Boise, Idaho, filed by taxpayer. 2/4/55, denied.

Mar. 15—Answer filed by General Counsel.

Mar. 21—Copy of answer served on taxpayer, Boise, Idaho.

Apr. 6—Request for place of hearing at Portland, Oregon, filed by General Counsel.

Apr. 8—Order denying respondent's request of 4/6/55 and vacating the action on petitioner's request of 2/4/55 and said request is granted and Boise, Idaho, or vicinity is now designated as place of hearing, entered.

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June 28—Hearing set October 8, 1956, Boise, Idaho.

Oct. 8—Trial had before Judge Bruce on merits. Submitted on stipulation of facts. Stipulation of facts with joint exhibits 1-A thru 7-G, and notice to produce, filed at hearing. Petitioner's brief, 11/23/56; respondent's brief, 12/24/56; petitioner's reply, 1/8/57.

Oct. 22—Transcript of Hearing 10/8/56, filed.

Nov. 20—Brief filed by petitioner. 11/21/56, served.

Dec. 17—Motion for extension of time to January 14, 1957, to file brief filed by respondent. 12/18/56, granted. Served 12/20/56.

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Jan. 14—Motion to extend time to 1/24/57 to file brief filed by respondent. 1/15/57, granted. Served 1/17/57.

Jan. 24—Brief filed by respondent.

Feb. 11—Reply brief filed by petitioner. Served 2/11/57.

May 31—Findings of fact and opinion filed. Bruce J. Decision will be entered. Served June 4, 1957.

June 4—Decision entered, Judge Bruce, Div. 6. Served 6/7/57.

Aug. 26—Motion by petitioner to withdraw Myron E. Anderson. 8/27/57, granted. Served 8/28/57.

Aug. 27—Order amending decision of June 5, 1957, entered. Served 8/29/57.

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- Aug. 30—Petition for review by U.S.C.A. 9th, with proof of service thereon, filed by petitioners.
- Aug. 30—Entry of appearance of Paul Castoldi as counsel filed.
- Aug. 30—Entry of appearance of Francis J. Butler as counsel filed.
- Sept. 5—Proof of service of petition for review filed.
- Sept. 13—Statement of Points with proof of service thereon filed.
- Sept. 13—Designation of Contents of Record on review with proof of service thereon filed.

In the Tax Court of the United States

Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau Symbols Ap:P:AA:REK), dated November 18, 1954, and as a basis of this proceeding they allege as follows:

I.

The petitioners are individuals and husband and wife whose residence are, and were during the taxable years, in St. Maries, Idaho. The return for the year of 1951, was filed as a joint return on a community property basis with the Collector of Internal Revenue for the District of Idaho. The return for the year of 1952, was filed as a joint return on a community property basis with the Director of Internal Revenue for the District of Idaho.

II.

The notice of deficiency dated November 18, 1954 (copy of which is attached and marked Exhibit "A") was mailed to petitioners on or after the date of the notice.

III.

The Commissioner has determined deficiencies in income tax for the year ending December 31, 1951, in the amount of \$2,155.22, and for the year ending December 31, 1952, in the amount of \$14,056.20 and penalties under Section 294(d)(2)IRC for the year of 1951 of \$356.93, and for the year of 1952, \$986.14, all of which are in controversy.

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The determination that all except one ninth of the net income from the partnership of Spiesman and Sons for the period from December 1st, 1951, to December 31st, 1951, was taxable to petitioners.

(b) The determination by the Commissioner that all of the amount of \$3,111.00 claimed as a bad debt deduction should be treated as a non-business bad debt and the adjustment resulting therefrom as a Short-Term Capital Loss carry forward.

(c) The determination by the Commissioner that petitioners underestimated their income tax for the year of 1951 and that taxpayers were subject to the penalty under Section 294 (d)(2)IRC.

(d) The determination that petitioners understated their income from the partnership of Spiesman and Resor for the year of 1952.

(e) The determination by the Commissioner that all except one-ninth of the income from the partnership of Spiesman and Sons for the period from 1/1/52 to 12/31/52 was taxable to petitioners.

(f) The adjustment made by the Commissioner to net gain from sale of Capital Assets.

(g) The failure of the Commissioner to recognize the grandchildren of Mathew J. Spiesman, Sr., who are also the children of Mathew J. Spiesman, Jr., as partners in the partnership of Spiesman and Sons, and the failure to recognize that the children were each bona fide owners of one-ninth interest in said partnership.

(h) The determination by the Commissioner that the earnings of Spiesman and Sons were primarily from the Capital and Services of Mathew J. Spiesman, Jr.

(i) The determination by the Commissioner that petitioners underestimated their income tax for the year of 1952 and that they are subject to the penalty under section 294(d)(2)IRC.

V.

The facts upon which the petitioner relies as the basis for this proceedings are as follows:

Preliminary Facts

(a) Petitioners filed a timely income tax return for the years of 1951 and 1952 reporting a net income of \$41,442.84, for the year 1951 and net income of \$30,199.84 for the year of 1952.

(b)(1) Included in the gross income reported in said Federal income tax return for the year of 1951 was partnership income from the partnership of Spiesman and Spiesman of \$33,562.81, income from the partnership of Spiesman and Sons, of \$1,084.76, and from the partnership of Spiesman and Resor of \$230.84. Also claimed in said return was a deduction for bad debts of \$3,411.00.

(2) Included in the gross income reported for the year of 1952 was partnership income from the partnership of Spiesman and Sons of \$16,940.61 and partnership income from Spiesman and Resor of \$136.64.

(c)(1) For the period from 1/1/51 to 11/30/51 the partnership of Spiesman and Spiesman (Mathew J. Spiesman, Sr., and Mathew J. Spies-

man, Jr.) filed an information return on form 1065 showing a net income of \$50,344.21, said information return showed the net income divisible one-third to Mathew J. Spiesman, Sr., and two-thirds to petitioners.

(2) For the period from 12/1/51 to 12/21/51 the partnership of Spiesman and Sons filed information return on form 1065 showing a net income of \$3,254.30, said information return showed the net income divisible one-third to petitioners, one-ninth each to the following: Mathew J. Spiesman, Sr.; Mathew J. Spiesman, III; Philip Spiesman, Michael Joe Spiesman; Leonard Spiesman and Francis Spiesman.

(3) For the taxable year ending December 31, 1952, the partnership of Spiesman and Resor, filed an information return showing a net income of \$273.28, said information return showed the income divisible one-half to petitioners and one-half to Stanley Resor.

(4) For the taxable year ending December 31, 1952, the partnership of Spiesman and Sons filed information returns on form 1065 showing a net income of \$46,021.71, said information return showed that the income was divisible one-third to petitioners and one-ninth to each of the following; Mathew J. Spiesman, Sr.; Mathew J. Spiesman, III; Michael Joe Spiesman; Philip Spiesman; Leonard Spiesman and Francis Spiesman.

Partnership Issue

(d) The partnership of Spiesman and Spiesman was the predecessor of the business of Spiesman and Sons. The equipment, consisting chiefly of coin operated amusement and gaming devices, were owned equally by Mathew J. Spiesman, Sr., and Mathew J. Spiesman, Jr., however, the profits were distributed one-third to Mathew J. Spiesman, Sr., and two-thirds to petitioners.

(e)(1) That Mathew J. Spiesman, Sr., was in the Cigar and Pool Hall business from 1911 until he sold out in 1935. At that time he went into semi-retirement.

(2) That on or about the 1st of May, 1938, he made a gift to his son Mathew J. Spiesman, Jr., in order that his son could purchase one-half interest in the business formerly owned by Mathew J. Spiesman, Sr. Mr. Stanley Resor purchased the other one-half and thus the partnership of Spiesman and Resor was formed .

(3) That in 1943 Mathew J. Spiesman, Sr., gave his son Mathew J. Spiesman, Jr., a house and lot in the town of St. Maries, Idaho.

(4) That during the year of 1944 Mathew J. Spiesman, Sr., helped organize and financed the Gem State Club, a non-profit club organized under the laws of the State of Idaho.

(5) That in 1945 Mathew J. Spiesman, Sr., desiring to further distribute part of his estate while

he was alive and also desiring to assist in making his grandchildren financially independent made gifts of dividend paying stocks to his grandchildren, Leonard J. Spiesman and Michael Joe Spiesman, and during the same year gave his son Mathew J. Spiesman, Jr., another house and lot in St. Maries, Idaho.

(6) That in the month of January, 1946, Mathew J. Spiesman, Sr., made further gifts of dividend paying stock to his grandchildren, Philip J. Spiesman, Michael Joe Spiesman and Leonard Spiesman and to his son Mathew J. Spiesman, Jr.

(7) That on January 9th, 1951, Mathew J. Spiesman, Sr., made a gift of dividend paying stock to his grandchild Mathew J. Spiesman, III.

(8) That Mathew J. Spiesman, Sr., read an article in the October, 1951, issue of "U.S. News and World" report at page 68, which indicated that under the new law that children could be made partners by giving, or selling, them the ownership in the property or business. He advised his son that he desired to give the grandchildren his interest in the partnership of Spiesman and Spiesman and asked his son to contact the Bureau of Internal Revenue and determine if the article he had read was correct. His son did contact the Bureau of Internal Revenue office at Boise, Idaho, and was given a copy of the new law, now section 191, I.R.C. and the amendment to section 3797 I.R.C. and was told that if bona fide transfers of ownership in property were made to minors that the minors would be rec-

ognized and entitled to their share of the income from the property.

(9) That on December 1st, 1951, Mathew J. Spiesman, Sr., gave 7/18th of interest in the equipment in the partnership of Spiesman and Spiesman to his five grandchildren.

(10) That on December 1st, 1951, petitioners gave 100 shares of Bunkerhill and Sullivan Mining Co. stock to his son, Mathew J. Spiesman, III; and a like amount of the same stock to his son, Francis Edward Spiesman. Petitioners also gave 3/18th of their interest in the equipment in the partnership of Spiesman and Spiesman to their five children, heretofore named.

(f) On December 1st, 1951, the Partnership of Spiesman and Spiesman was discontinued and a new partnership formed by and between Mathew J. Spiesman, Sr; Mathew J. Spiesman, Jr; Mathew J. Spiesman, III; Machael J. Spiesman; Philip J. Spiesman; Leonard J. Spiesman and Francis E. Spiesman. Said partnership was to be known as Spiesman and Sons and was organized for the purpose of carrying on the business of owning and operating coin operated amusement and gaming devices and the profits were shared one-ninth to all the partners except petitioners who received one-third of the profits. The partnership agreement is recorded in book six at page 558 of the Miscellaneous records of Benewah County, State of Idaho. There is an error in the first sentence of the fourth paragraph of said agreement and should have read

as follows: "At the time of this agreement, the assets to be taken over by the partnership are in possession and owned equally by the partners Mathew J. Spiesman, Sr., and Mathew J. Spiesman, Jr., and are in a value of \$2,374.63." It was the intention of Mathew J. Spiesman, Sr., to transfer by gift all but one-ninth of his one-half interest in the equipment to his grandchildren and it was the intention of petitioners to transfer by gift all but one-third of their one-half interest in the equipment to their children. It also was intended that each should invest \$100.00, for each one-ninth interest owned. This partnership is still in existence, though the income of same has materially dropped due to the outlawing of coin-operated gaming devices within the state, and the purpose and intent of the partnership is being carried out in the terms of the partnership agreement. This partnership is valid under the Idaho State law and is valid under section 191 I.R.C. and 3797 I. R. C.

(g) Mathew J. Spiesman, Jr., was duly appointed guardian of Michael J. Spiesman; Philip J. Spiesman; Leonard J. Spiesman; and Mathew J. Spiesman, III, on April 17th, 1947, and he was appointed guardian of Francis E. Spiesman on October 13th, 1953. Mathew J. Spiesman was acting in his fiduciary capacity and for the interest of the children when he accepted the gifts which made them members of the partnership of Spiesman and Sons. The probate court of Benewah County, has approved the partnership venture.

(h) Mathew J. Spiesman, Jr., receives a salary as manager of Spiesman and Son of \$250.00 per month which is a reasonable salary for his services. He also received a salary from the Gem State Club of \$6,000.00 per year in 1951 and 1952.

(i) Ownership of the equipment is an important income-producing factor and petitioners owning only one-third of the coin operated amusement and gaming devices, etc., are entitled to one-third of the profits. The children are real and bona fide owners of one-ninth interest each in the coin operated amusement and gaming devices and are entitled to and did report one-ninth of the income.

(j) The examination of the partnership of Spiesman and Resor was not discussed with Mathew J. Spiesman, Jr., and a copy of the examiners report was not furnished to petitioners until a short time ago. Petitioner does not believe the position taken by the examining officer is correct but inasmuch as most of the changes shifted income from one year to another petitioner will accept the proposed adjustments for 1952.

Bad Debt Issue

(k) Petitioners deducted on page three of their 1951 return an item of \$3,411.00, as bad debts. Three hundred dollars of this amount has since become collectable and therefore petitioners concede that that amount should be disallowed in its entirety. Six hundred ninety one dollars was loaned to patrons to play the coin operated gaming devices and there-

fore should be allowed as a business bad debt. The balance of \$2,420.00 is conceded to be a non-business bad debt and should be treated as short term capital loss.

Capital Gain and Loss Issue

(1) This adjustment stems from the consideration of the bad debts being treated as short term Capital loss. Of \$2,420.00 non-business bad debt conceded the amount of \$1,355.92 should be deducted as Short Term Capital loss in 1951 and the amount of \$1,064.08, carried forward to 1952.

Penalty Issue

(1) There was no intention on the part of petitioners to violate the law or evade taxation, but taxpayers estimated their tax to the best of their ability. The proposed deficiency in tax is entirely from the attempt of the Commissioner to shift the income to petitioners that the tax has already been paid on by others.

Wherefore, the petitioners pray that this Court may hear the proceedings and determine:

That the partnership of Spiesman and Sons is a valid partnership.

That the petitioners are taxable on one-third of the net income of the Partnership of Spiesman and Sons for the period from 12/1/51 to 12/31/51 and for the taxable year ending 12/31/52.

That for the year of 1951, the amount of \$691.00 be determined to be a business bad debt and allow-

able in full and that the amount of \$2,420.00 be determined as non-business bad debts.

That a short term Capital loss be allowed in 1951, in the amount of \$1,355.92, and that the amount of \$1,064.08, be carried forward as a short term capital loss to the taxable year of 1952.

That petitioners are not liable for the penalties under section 294(d)(2) for the taxable years of 1951 and 1952.

That there is a deficiency for the taxable year of 1951 of \$736.58, and a deficiency in 1952 of \$320.84.

/s/ MYRON E. ANDERSON,
Attorney for Petitioners.

Duly verified.

EXHIBIT A

Form 1231 (App.)

U. S. Treasury Department
Internal Revenue Service
Regional Commissioner
Appellate Division
P. O. Box 3935
Portland, Oregon

Nov. 18, 1954.

In Replying Refer to
Ap:P:AA:REK
90D:LS

Mathew J., Jr., and Mary Spiesman,
St. Maries, Idaho.

Dear Mr. and Mrs. Spiesman:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1951, and December 31, 1952, discloses deficiencies in tax aggregating \$16,211.42 and penalties aggregating \$1,343.07, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, P. O. Box 3935, Portland, Oregon. The signing and filing of this form will expedite the closing of your case by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on

the date of assessment, or on the date of payment, whichever is the earlier.

Very Truly Yours,

T. COLEMAN ANDREWS,
Commissioner.

By /s/ BOWDEN SAMMIS,
Acting Assistant Chief,
Appellate Division.

Enclosures:

Statement.

Form 1276.

Agreement Form.

Ap:P:AA:REK

90D:LS

Statement

Mathew J., Jr., and Mary Spiesman
St. Maries, Idaho

Tax Liability for the Taxable Years Ended December
31, 1951, and December 31, 1952

Income Tax				Section 294(d)(2) Penalty
Year	Liability	Assessed	Deficiency	
1951	\$16,106.36	\$13,951.14	\$ 2,155.22	\$ 356.93
1952	23,760.12	9,703.92	14,056.20	986.14
	<hr/>	<hr/>	<hr/>	<hr/>
Totals	\$39,866.48	\$23,655.06	\$16,211.42	\$1,343.07
	<hr/>	<hr/>	<hr/>	<hr/>

In making this determination of your income tax liability, careful consideration has been given to the report of examination, a copy of which was mailed to you on March 26, 1954.

It is held that you substantially underestimated your tax liability for 1951 and 1952, and the 6% penalty for substantial underestimation of estimated tax is accordingly asserted under section 294(d)(2), 1939 Internal Revenue Code.

Inasmuch as the distribution of partnership income from Spiesman & Sons for 1952 has been revised by adding to your income the amounts previously shown as income of your dependent children, you are allowed five exemptions for 1952 rather than three as shown by the 1952 return.

A copy of this letter and statement has been mailed to your representative, Mr. Myron E. Anderson, 612 Idaho Building, Boise, Idaho, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended December 31, 1951

Adjustments to Net Income

Net income as disclosed by return.....		\$41,442.84
Unallowable deductions and additional income:		
(a) Partnership income increased \$ 1,807.95		
(b) Miscellaneous deductions		
decreased	3,411.00	5,218.95
		<hr/>
Total		\$46,661.79
Nontaxable income and additional deductions:		
(c) Net gain from sale of capital assets decreased		1,355.92
		<hr/>
Net income adjusted		\$45,305.87
		<hr/> <hr/>

Explanation of Adjustments

(a) Partnership income increased

Examination of the books and records of the partnership of Spiesman & Sons, St. Maries, Idaho, discloses that your share of the distributable income for the year is \$2,892.71. Inasmuch as you reported \$1,084.76, your taxable income has been increased by the difference of \$1,807.95, computed as follows:

Ordinary net income per partnership return	\$3,254.30
	<hr/>
Corrected partnership ordinary net income	\$3,254.30
	<hr/>
Your distributive share	\$2,892.71
Partnership income reported on your return	1,084.76
	<hr/>
Understatement of partnership income	\$1,807.95
	<hr/> <hr/>

Explanation of partnership adjustments:

The income returned by your minor children as their respective distributive shares of partnership income has been eliminated from their incomes and included in your income in the total amounts shown above. It is determined that they were not partners for Federal income tax purposes under sections 191 and 3797(a)(2) of the Internal Revenue Code of 1939, as amended, and that the earnings of the business, Spiesman & Sons, are primarily attributable to the services of Mathew J. Spiesman, Jr., and your capital contributions; and further, that to no substantial extent are such earnings attributable to either capital or services of any of said minor children.

(b) Miscellaneous deductions decreased

It is held that nonbusiness bad debts may not be deducted as miscellaneous deductions. Accordingly, taxable income is increased by \$3,411.00. Under section 23(k), 1939 Internal Revenue Code, nonbusiness bad debts are to be considered as short-term capital losses and the \$3,411.00 is taken into account in adjustment (c), below.

(c) Net gain from sale of capital assets decreased

In adjustment (b), above, nonbusiness bad debts totaling \$3,411.00 were disallowed since nonbusiness bad debts must be treated as short-term capital losses under section 23(k), 1939 Internal Revenue Code, in the year they become worthless. It is held that \$3,111.00 of the \$3,411.00 became worthless in 1951.

Under section 117, 1939 Internal Revenue Code, the deduction for a net capital loss is limited to \$1,000.00. Thus, taxable income for 1951 is reduced by \$1,355.92. Computation is as follows:

Net long-term capital gain—per return.....	\$ 355.92
Nonbusiness bad debts treated as short-term capital losses	(3,111.00)
Balance	(\$2,755.08)
Less capital loss carry-over to 1952	1,755.08
Net capital loss deduction for 1951	(\$1,000.00)
Net capital gain reported on 1951 return	355.92
Reduction of 1951 taxable income	(\$1,355.92)

Computation of Income Tax

Net income as adjusted	\$45,305.87
Less exemptions (5 times \$600.00)	3,000.00
	<hr/>
Balance subject to tax	\$42,305.87
	<hr/>
One-half of \$42,305.87—joint return	\$21,152.94
	<hr/>
Tax on \$21,152.94	\$ 8,053.18
	<hr/>
Total tax liability—2 times \$8,053.18	\$16,106.36
Assessed: Liability disclosed by return— original account No. BF 705—Idaho	13,951.14
	<hr/>
Deficiency	\$ 2,155.22
	<hr/> <hr/>
Liability for penalty: Section 294(d) (2), Internal Revenue Code:	
Total tax liability as adjusted	\$16,106.36
Less: Tax withheld\$ 657.60	
1951 estimated	
tax 9,500.00	10,157.60
	<hr/>
Balance	\$ 5,948.76
	<hr/> <hr/>
Penalty—6% of \$5,948.76	\$ 356.93
	<hr/> <hr/>

Taxable Year Ended December 31, 1952

Adjustments to Net Income

Net income as disclosed by return	\$30,199.84
Unallowable deductions and additional income:	
(a) Partnership income increased	25,333.90
	<hr/>
Total	\$55,533.74
Nontaxable income and additional deductions:	
(b) Net gain from sale of capital assets decreased	885.09
	<hr/>
Net income adjusted	\$54,648.65
	<hr/> <hr/>

Explanation of Adjustments

(a) Partnership income increased

Examination of the books and records of the partnership of Spiesman and Resor Pool Hall, St. Maries, Idaho, discloses that your share of the distributable income for the year 1952 is \$1,236.29. Inasmuch as you reported \$136.64, your taxable income has been increased by the difference of \$1,099.64, computed as follows:

Ordinary net income per partnership return.....	\$ 3,273.28	
Add unallowable deductions and additional income:		
1. Sales	\$ 799.30	
2. Credit sales	1,400.00	2,199.30
		<hr/>
Corrected partnership ordinary net income	\$ 5,472.58	
		<hr/>
Your distributive share	\$ 1,236.29	
Partnership income reported on your return	136.64	
		<hr/>
Understatement of partnership income	\$ 1,099.65	
Add understatement of partnership income from		
Spiesman & Sons, shown below	24,234.25	
		<hr/>
Total increase in partnership income	\$25,333.90	
		<hr/> <hr/>

Explanation of partnership adjustments:

1. Gross receipts were inadvertently understated by \$799.30, and adjustment is made accordingly.

2. Since credit sales of \$1,400.00 on merchandise sold to Gem State Club, Inc., were not included in income, adjustment is made accordingly.

Examination of the books and records of the partnership of Spiesman & Sons, St. Maries, Idaho, discloses that your share of the distributable income for the year 1952 is \$41,174.86. Inasmuch as you reported \$16,940.61, your taxable income has been increased by the difference of \$24,234.25, computed as follows:

Ordinary net income per partnership return	\$46,021.71	
		<hr/>
Corrected partnership ordinary net income	\$46,021.71	
		<hr/>

Your distributive share	\$41,174.86
Partnership income reported on your return	16,940.61
	<hr/>
Understatement of partnership income	\$24,234.25
	<hr/> <hr/>

Explanation of partnership adjustments:

The income returned by your minor children as their respective distributive shares of partnership income has been eliminated from their incomes and included in your income in the total amounts shown above. It is determined that they were not partners for Federal income tax purposes under sections 191 and 3797(a)(2) of the Internal Revenue Code of 1939, as amended, and that the earnings of the business, Spiesman & Sons, are primarily attributable to the services of Mathew J. Spiesman, Jr., and your capital contributions; and further, that to no substantial extent are such earnings attributable to either capital or services of any of said minor children.

(b) Net gain from sales of capital assets decreased

Since it is held that there is now a capital loss carry-over from 1951 to 1952, taxable income for 1952 is accordingly reduced by \$885.09. Computation is as follows:

Net short-term capital loss—per return	(\$ 221.60)
Add capital loss carry-over from 1951	(1,755.08)
	<hr/>
Total	(\$1,976.68)
Less net long-term capital gain—per return— at 100%	1,961.59
	<hr/>
Net capital loss deduction, as adjusted	(\$ 15.09)
Net capital gain reported on return	870.00
	<hr/>
Reduction of 1952 taxable income	(\$ 885.09)
	<hr/> <hr/>

Computation of Income Tax

Net income as adjusted	\$54,648.65
Less exemptions (5 times \$600.00)	3,000.00
	<hr/>
Balance subject to tax	\$51,648.65
	<hr/> <hr/>

One-half of \$51,648.65—joint return	\$25,824.33	
Tax on \$25,824.33	\$11,880.06	
Total tax liability—2 times \$11,880.06	\$23,760.12	
Assessed: Liability disclosed by return— original account No. AF 702924— Idaho	9,703.92	
Deficiency	\$14,056.20	
Liability for penalty: Section 294(d) (2), Internal Revenue Code: Total tax liability as adjusted	\$23,760.12	
Less: Tax withheld	\$ 824.40	
1952 estimated tax	6,500.00	7,324.40
Balance	\$16,435.72	
Penalty—6% of \$16,435.72		\$ 986.14

Received and filed January 28, 1955, T.C.U.S.

Served January 31, 1955.

[Title of Tax Court and Cause.]

Docket No. 56141

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits, denies and alleges as follows:

1. Admits the allegations contained in paragraph I of the petition.

2. Admits the allegations contained in paragraph II of the petition.

3. Admits the allegations contained in paragraph III of the petition.

4. Denies that he erred in his determination of the deficiencies in income tax and penalties as shown by the notice of deficiency from which the appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph IV (a) to (i), inclusive, of the petition.

5. (a) Admits the allegations contained in paragraph V (a) of the petition.

(b)(1) Admits that the petitioners included in the gross income reported in their Federal income tax return for the taxable year 1951 partnership income in the total amount of \$34,878.41. Admits that petitioners in said return claimed as a page 3 deduction an item listed as "Bad Debt Losses-Personal Loans" in the amount of \$3,411.00. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph V(b)(1) of the petition.

(b)(2) Admits the allegations contained in paragraph V(b)(2) of the petition.

(c)(1) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allega-

tions contained in paragraph V(c)(1) of the petition.

(c)(2) Alleges that a partnership return for Spiesman and Sons for the period from December 1, 1951, through December 31, 1951, was filed showing a net income of \$3,254.30, and as thus qualified admits the allegations contained in paragraph V(c)(2) of the petition.

(c)(3) for lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(c)(3).

(c)(4) Admits that for the taxable year ending December 31, 1952, the partnership of Spiesman and Sons filed information returns on Form 1065 showing a net income of \$46,021.71. Denies the remaining allegations contained in paragraph V(c)(4) of the petition.

(d) to (h), inclusive. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(d) to (h), inclusive, of the petition.

(i) Denies the allegations contained in paragraph V(i) of the petition.

(j) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(j) of the petition.

(k) Admits the allegations contained in the first two sentences of paragraph V(k) of the petition. Denies the allegations contained in the third sentence of paragraph V(k) of the petition. Admits the allegations contained in the last sentence of paragraph V(k) of the petition.

(l) Denies the assumptions, allegations and conclusions contained in paragraph V(1) of the petition.

(m) Denies the allegations contained in the last subparagraph, entitled "Penalty Issue," of paragraph V of the petition.

6. Denies generally and specifically each and every material allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioners' appeal be denied and that the Commissioner's determination of the deficiencies and penalties be approved.

/s/ R. P. HERTZOG,
Acting Chief Counsel,
Internal Revenue Service.

Filed: March 15, 1955, T.C.U.S.

[Title of Tax Court and Cause.]

MINUTES OF PROCEEDINGS

OCTOBER 8, 1956

Action: Submitted on stipulation of facts.

Filed at hearing: Stipulation of facts with joint Exhibits 1-A thru 7-G. Notice to Produce.

Petitioner's brief: Nov. 23, 1956; Jan. 8, 1957.

Respondent's brief: Dec. 24, 1956.

Witnesses for Petitioner:

Mathew J. Spiesman, Sr.,
Mathew J. Spiesman, Jr.,
Kenneth Esmay.

Witnesses for Respondent.

Claude F. Flower.

Petitioner's Exhibits:

8. Photostat copy of magazine article titled "Should You Buy Shares in America."

9. Copy of Partnership Agreement as of first day of Feb., 1950, by & between M. J. Spiesman, Jr., all of St. Maries, Benewah County, Idaho.

10. Original Partnership Agreement as of 1st Dec., 1951, by & between Mathew James Spiesman, Sr.; Mathew James Spiesman, Jr.; Michael Joseph Spiesman; Mathew James Spiesman, III; Philip James Spiesman; Leonard John Spiesman; & Francis Edw. Spiesman.

11. Certificate titled "Letters of Guardianship.

12. Certificate titled "Letters of Guardianship," Francis Edw. Spiesman, minor.

13. Copies of Annual Inventory & Accounting. Nine separate groups.

14. Order settling inventory & accounting & report of Guardian.

15. Ident.: Not offered in evidence.

16 thru 20. Duplicate deposit slips, dated 3-17-52, Savings Dept. of Farmers & Merchants Bank of Rockford, in the respective order. Phillip James Spiesman; Francis E. Spiesman; Michael Joe Spiesman; Mathew J. Spiesman, III; Leonard John Spiesman.

21. Letter from Farmers & Merchants Bank of Rockford, Rockford, Wash., showing dates cleared the bank & signed by Claude F. Flower.

22. Ident.: Not offered in evidence.

Respondent's Exhibits:

H. Original certificate, 10 pages, certified copies of Guardianship proceedings relating to four minor children of the petitioner.

I. Bank record of Spiesman & Sons, St. Maries.

J. Record of savings account of Philip J. Spiesman, Farmers & Merchants Bank.

K. Record of savings account of Michael Joe Spiesman, Farmers & Merchants Bank.

L. Record of savings account of Mathew J. Spiesman, III, Farmers & Merchants Bank.

M. Record of savings account of Leonard John Spiesman, Farmers & Merchants Bank.

N. Record of savings account of Francis E. Spiesman, Farmers & Merchants Bank.

Note: Respondent's exhibits were offered into evidence as the originals, I thru N, and they are now to be replaced with photostat copies. (10/8/56.)

/s/ ROY E. MAY,
Deputy Clerk.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys of record, that the following facts are true and that the same may be so considered and accepted by the Court as offered in evidence by the parties at these proceedings; provided, however, that the stipulation shall be without prejudice to the right of either of said parties to introduce other and further evidence.

1. Petitioners are husband and wife residing at St. Maries, Idaho. Joint federal income tax returns of petitioners for the calendar years 1951 and 1952 were filed with the then Collector of Internal Revenue for the District of Idaho, for the calendar year 1951, and with the District Director of Internal Revenue, Boise, Idaho, for the calendar year

1952. Attached hereto and made a part hereof as Exhibits 1-A and 2-B are true and correct copies (photostatic) of said joint individual income tax returns of petitioners for the calendar years 1951 and 1952, respectively.

2. On Schedule C of their joint income tax return for the calendar year 1951, petitioners reported the amount of \$34,878.41 as income from partnerships. Attached hereto and made a part hereof as Exhibits 3-C, 4-D, and 5-E are true and correct copies (photostatic) of a partnership information return (Form 1065) of Mathew J. Spiesman, Sr., and Jr., for the taxable period beginning January 1, 1951, and ending December 1, 1951; a partnership information return (Form 1065) of the Spiesman & Resor Pool Hall for the calendar year 1951; and a partnership information return (Form 1065) of Spiesman & Sons for the taxable period beginning December 1, 1951, and ending January 1, 1952, respectively.

3. On Schedule C of their joint income tax return for the calendar year 1952, petitioners reported the amount of \$17,079.25 as income from partnerships. Attached hereto and made a part hereof as Exhibits 6-F and 7-G are true and correct copies (photostatic) of a partnership information return (Form 1065) of Spiesman & Sons for the calendar year 1952, and of Spiesman & Resor Pool Hall for the calendar year 1952, respectively.

4. Included in the total amount of partnership income reported by petitioners in their joint income

tax return for the calendar year 1952, was the sum of \$136.64 which represented the petitioners' share of the ordinary net income of the Spiesman & Resor Pool Hall partnership, all as set forth on Schedule K of Exhibit 7-G, above. It is agreed by and between the parties hereto that adjustments should be made to the ordinary partnership income as reported in Exhibit 7-G due to an inadvertent understatement of partnership gross receipts and omissions of credit sales of merchandise. The parties further agree that the petitioners' correct share of the distributable income from the Spiesman & Resor Pool Hall partnership for the calendar year 1952 is \$1,236.29.

5. On their joint income tax return for the calendar year 1951, petitioners claimed as a miscellaneous deduction on page 3 thereof the sum of \$3,411.00 which amount was described on said return as "Bad Debt Losses-Personal Loans." It is hereby conceded by petitioners that only \$3,111.00 of the \$3,411.00 claimed on said return became worthless during the calendar year 1951. Petitioners further concede that the balance of \$3,111.00 actually represents non-business bad debts which should be treated under the applicable provisions of the Internal Revenue Code of 1939 as a short term capital loss.

6. By an amended Declaration of Estimated Tax (Form 1040-ES) dated January 15, 1952, and filed with the then Collector of Internal Revenue for the

District of Idaho, petitioners estimated their income tax for the calendar year 1951 to be \$9,500.00. Petitioners paid the amount of \$9,500.00 on their estimated income tax for the calendar year 1951 and paid \$657.60 as an amount withheld from wages and salaries by an employer during 1951.

7. By an amended Declaration of Estimated Tax (Form 1040-ES) dated January 15, 1953 and filed with the District Director of Internal Revenue, Boise, Idaho, petitioners estimated their income tax for the calendar year 1952 to be \$6,500.00. Petitioners paid the amount of \$6,500.00 on their estimated income tax for the calendar year 1952 and paid \$824.40 as an amount withheld from wages and salaries by an employer during 1952.

/s/ MYRON E. ANDERSON,
Counsel for Petitioners.

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel
for Respondent.

Filed at hearing October 8, 1956.

The Tax Court of the United States

Docket No. 56141

In the Matter of:

MATHEW J. SPIESMAN, JR., et al.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PROCEEDINGS

Monday, October 8, 1956

The above-entitled matter came on for hearing,
pursuant to Calendar Call, at 10:45 o'clock a.m.

Before: The Honorable J. Gregory Bruce.

Appearances:

MYRON E. ANDERSON,

On Behalf of the Petitioner.

WENDELL M. BASYE,

On Behalf of the Respondent.

The Court: Are you ready to proceed in the case
of Mathew J. Spiesman, Jr., and others, Docket No.
56141?

Mr. Andersen: Yes, Your Honor.

Mr. Basye: Respondent is ready for trial.

The Court: Will you announce your appear-
ances again for the record.

Mr. Andersen: Myron E. Andersen for petitioner.

Mr. Basye: Wendell Basye, counsel for respondent.

The Court: Very well. Does the petitioner wish to make an opening statement?

Mr. Andersen: Yes, Your Honor.

There were three issues in this case when we started, a bad debt issue, a family partnership issue and penalty for underestimating. We have conceded the bad debt issue, so there will be just the two issues, and the main one being the family partnership.

The Court: You are conceding the issue with respect to bad debt?

Mr. Andersen: That is right. We had taken the position that \$691 was a business bad debt, the government had taken the position that it was a non-business bad debt, and we have conceded rather than argue.

The Court: According to your pleadings, there was a total amount of \$3,411. [3*]

Mr. Andersen: That is right.

The Court: You are now conceding that the respondent's contention——

Mr. Andersen (Interrupting): There were \$300 which we conceded in the petition was not deductible at all.

The Court: Not deductible at all. And the balance is a non-business bad debt?

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

Mr. Basye: The \$300 was alleged in the petition to have not become worthless at all, but later recovered, so it was in the amount of 3,100-some dollars which was originally in issue.

The Court: The \$3,411 with the \$300 taken off of that, the remaining amount, then, the petitioner is conceding, represents a non-business bad debt?

Mr. Basye: Yes, sir.

The Court: All right.

Mr. Andersen: The main issue in this case, of course, is that it is a family partnership, is whether or not the petitioner's children, five minor children, are partners in the business known as Spiesman & Sons. The Commissioner of Internal Revenue has taken a position that they were not partners and proposed to tax the children's share of the distributable income from said partnership to petitioners. The applicable section of the Internal Revenue Code is 6191 and 379(a)(2) 1939 Code as amended by Section 340(a) and (b) of the Revenue Act of 1951. The effective date of the said Act as it pertains [4] to this case is January 1, 1951, so that, inasmuch as the years of '51 and '2 are involved, they are under the new Partnership Rule, Family Partnership Rule.

The partnership of Spiesman & Sons was formed on December 1, 1951, for the purpose of owning and operating gaming and amusement devices.

The Court: Organized when?

Mr. Andersen: December 1, 1951.

The Court: Go ahead.

Mr. Andersen: Prior to the formation of the

partnership of Spiesman & Sons there was a partnership conducted by Mathew J. Spiesman, Sr., and Mathew J. Spiesman, Jr., and that was known more commonly as Spiesman & Spiesman, that is, the grandfather, the father of the children, and of course there were the children.

We will show that the equipment owned by the partnership of Spiesman & Spiesman was owned equally by the partners, that is, the father and grandfather, and that the income from that partnership was divided one-third to M. J. Spiesman, Sr., and two-thirds to M. J. Spiesman, Jr.

The Court: Although they owned the——

Mr. Andersen (Interrupting): They owned the assets——

The Court: They owned the assets equally?

Mr. Andersen: Equally. The division of profit. That partnership ended on December 1, 1951, and the new [5] partnership, bringing in the minor children, began on that date.

We will show that Mathew J. Spiesman, Sr., was dividing his estate, and he had made gifts of his interest, a portion of his interest, in the equipment to the minor children.

One important point, I think, that is very obvious here is that the income that the children received was taxed for the year or for the period beginning after December 1, 1951, through 1952, to the father instead of any of it being taxed back to the grandfather, Mr. M. J. Spiesman, Sr.

I think that is all I have to say with regard to the family partnership.

On the penalty for underestimating well, we believe there is reasonable cause and we will show reasonable cause. However, it has been the policy of this office here to take the position that it's been mandatory that it be put on. I think that is all, Your Honor, on the opening statement.

The Court: Does the respondent wish to make a statement?

Mr. Basye: If the Court please. Your Honor, we are substantially in agreement with the opening statement of the petitioner. Actually the tax years involved in the proceeding are 1951 and 1952. In the deficiency notice sent out in this case, a deficiency in income tax was asserted for the year 1951 in the amount of \$2,155.22, for the year of 1952 in the amount of \$14,056.20. There were also assertions of added [6] amounts, as involves the year 1951, \$693, and for the year 1952, \$986.14.

As pointed out by the petitioner, the case does involve the recognition of five minor children, which, we think evidence will be shown, that at the time were 2 and 12 years old, as partners in a partnership which was conducting the operating and maintenance of certain slot machines, gaming devices and other coin-operated amusement devices. In this regard, it is the respondent's position in the case that, first, from all the circumstances surrounding the acquisition and alleged ownership of a capital interest in Spiesman & Sons partnership by the five minor children of petitioner, we believe, we would lead to the conclusion that the interest of the minors in the partnership does not meet the various tests

laid down in Section 39.191-B-8 of Treasury Regulations 118.

The Court: What regulation is that?

Mr. Basye: Regulations 118, Section 39.191-B-8, dealing with interests of minors in partnership.

The Court: Very well.

Mr. Basye: The second position of the respondent, Your Honor, is that we ask the Court to take judicial notice of Section 50-1504 of the Idaho Code, dealing with the licensing during the years involved of the coin-operated amusement devices which, in this case, involve income to the partnership. [7] On this point, it is the respondent's position, Your Honor, that only M. J. Spiesman, Jr., the petitioner in this case, could under the Idaho law legally hold any right, title or interest in these various coin-operated devices, and secondly, that he was the only partner in the partnership who could, under the Idaho law, legally receive any rentals or remunerations from the operation of such devices.

It is the third position of respondent in this case, Your Honor, that to no substantial extent are the earnings of the business of Spiesman & Sons partnership attributable to either the capital or services of the five minor children.

The Court: You may call your first witness.

Mr. Andersen: Mr. M. J. Spiesman, Sr.

Mr. Basye: One moment, Your Honor.

There is a stipulation of facts to be entered in this case.

The Court: Is it ready?

Mr. Andersen: Yes, Your Honor.

The Court: Are you offering the stipulation?

Mr. Andersen: Yes, Your Honor.

The Court: All right, the parties are offering a stipulation of facts, to which are attached numbers——

Mr. Basye: Exhibits through 6-G, I believe, or 7-G, respectively—yes, sir, 1-A through 7-G, respectively. [8]

The Court: To which are attached Exhibits 1-A through 7-G, inclusive. The stipulation of facts, together with the exhibits attached thereto, will be received in evidence and made a part of the record herein.

(Petitioner-Respondent Exhibits Nos. 1-A through 7-G, respectively, were marked for identification and received in evidence.)

Mr. Andersen: Mr. M. J. Spiesman, Sr.

Mr. Spiesman, Your Honor, does not hear too well.

The Court: Very well.

M. J. SPIESMAN, SR.

was called as a witness on behalf of the petitioners and, having been first duly sworn, testified as follows:

The Clerk: Will you state your name, please?

The Witness: Mathew J. Spiesman.

The Clerk: Junior or Senior?

The Witness: Senior.

(Testimony of M. J. Spiesman, Sr.)

Direct Examination

By Mr. Andersen:

Q. Where do you reside?

A. St. Maries, Idaho.

Q. How old are you, Mr. Spiesman?

A. I will be 80 in January.

Q. Are you now married? A. No.

Q. You are a widower? [9] A. Yes.

Q. What is your nickname? A. Heinie.

Q. That is what you go by mostly, isn't it?

A. Yes.

Mr. Andersen: We may have to use it from time to time to keep the Spiesmans straight.

Q. (By Mr. Andersen): Do you have any children? A. Yes.

Q. How many? A. One.

Q. What is his name?

A. Mathew J. Spiesman, Jr.

Q. And your son and his wife are the petitioners in this case? A. Yes.

Q. Do you have any grandchildren?

A. Five.

Q. Can you give their names and ages?

A. I can try. Michael Joe Spiesman.

Q. How old is he?

A. He will be 16 this month, I believe. Yes.

Q. And the next one?

A. Phillip James Spiesman. [10]

Q. How old is Phillip? A. Thirteen.

(Testimony of M. J. Spiesman, Sr.)

Q. And the next one?

A. Leonard John Spiesman.

Q. How old is he? A. Well, I——

Q. You can look at your notes if they are in your own handwriting.

A. I wrote it down, figuring you would ask me that, and some others I——

The Court: I think you can agree on it. How old is he?

Mr. Andersen: I will have to look here.

A. Leonard John is 11 years old.

Q. (By Mr. Andersen): Then who is the next one? A. Mathew James.

Q. Mathew James Spiesman?

A. Ten years old.

Q. We call him Mathew III, don't we, as a rule?

A. Yes.

Q. And the next one?

A. And Francis Edward, 6.

Q. That is their ages at the present time?

A. At the present time. [11]

Q. At the time you formed the partnership their ages would have been: Michael Joe 11; Phillip 8; Leonard 6 Years 9 months; Mathew, III, 5 years 5 months; and Francis 1 year 2 months, is that right?

A. I think so, right, yes.

Q. What is the approximate population of St. Maries, Idaho?

A. About 2 thousand, I believe.

Q. It's a very small town? A. Yes.

Q. What is the principal industry?

(Testimony of M. J. Spiesman, Sr.)

A. Logging and lumbering.

Q. Then it is a seasonal, what you might call a seasonal town? A. Seasonal, yes.

Q. How long have you resided in St. Maries?

A. Well, I first came there in December of 1911, but I expect my residence would date from January, 1912.

Q. That would be about 44 years.

What is your present occupation, or what do you do?

A. Well, I am working in the Gem State Club, and I believe that is about all.

Q. Well, you are a partner in Spiesman & Sons?

A. Spiesman & Sons, yes.

Q. You were in business in St. Maries. When did you [12] begin business?

A. January, 1912.

Q. What kind of business was that?

A. It was a cigar store, billiard parlor, amusement place, I suppose.

Q. And you continued this business until when?

A. Well, I sold it to Dean Marty—well, I don't know—I believe in 1935.

Q. Was your son, Mathew James Spiesman, Jr., living with you at that time, in 1935? A. No.

Q. Where was he?

A. He was occupied in his profession, he was a professional ball player.

Q. He was away playing professional ball?

A. Yes.

(Testimony of M. J. Spiesman, Sr.)

Q. After you sold your business in 1935 did you stay in St. Maries or did you leave?

A. What?

Q. After you sold your business in 1935 did you leave or did you stay in St. Maries?

A. Well, I left St. Maries for a trip East and South into Florida, and I believe I brought, at the same time, his present wife rode with me, and they were married on the road.

Q. And when did you return to Idaho [13] again? A. In 1936.

Q. And you returned to St. Maries?

A. Yes.

Q. When did your wife pass away?

A. In 1937.

Q. Your son came home to his mother's funeral?

A. Yes.

Q. At that time did your son indicate to you what his plans were?

A. Well, yes, he figured that he was, he didn't want to play professional baseball any more, that he would like to get into business, and he would like to get into the same business that I had before I sold out.

Q. Did you make him any offer at that time?

A. Well, I told him that I would back him for to get an interest in the business, if we could buy it back.

Q. Did he ever take you up on the offer?

A. Yes.

Q. About when was that?

(Testimony of M. J. Spiesman, Sr.)

A. Well, that was, I believe, in 1938.

Q. And at that time did you make him a loan or a gift? A. Yes.

Q. Which was it, a loan or a gift? Did you make him a gift at that time? A. It was a gift. [14]

Q. Do you recall how much it was?

A. Well, closely, I believe—now, it's kind of hard for me to say that—it was around 23 hundred and some odd dollars, I believe.

Q. Twenty-three hundred seventy-five dollars is what you have reported.

The Court: What did he——

Mr. Andersen: He made a gift to his son in 1938 of \$2,375.

The Court: You said, "That is what you reported," is that right?

Mr. Andersen: I don't think it was reported as a gift tax, because it was under \$3,000, Your Honor. Honor.

The Court: I wondered why you were prompting the witness there, Mr. Andersen.

Mr. Andersen: I will try and keep from it, Your Honor.

Q. (By Mr. Andersen): At that time did he buy any business?

A. He bought a half-interest in my former business from Dean Marty.

Q. Was there a partnership formed then, at that time?

A. Resor, a gentleman by that name, bought the

(Testimony of M. J. Spiesman, Sr.)

other half and they formed a partnership of Spiesman and Resor.

The Court: You didn't have any interest in [15] that firm yourself at that time, then?

The Witness: No.

The Court: Proceed.

Q. (By Mr. Andersen): Have you made any further gifts to your son, Mathew, Jr.?

A. Yes.

Q. Would you tell the Court what gifts you have made subsequent to that to your son?

A. What?

Q. Can you tell the Court what gifts you have made since 1938 to your son, Mathew?

A. Well, not offhand, but I could look it up. I believe I have got notes to that effect, if I can look at them.

Q. You may look at them.

Mr. Andersen: Is that all right, Your Honor?

The Court: What kind of notes is it he is referring to?

Mr. Andersen: Show them to His Honor.

The Court: Are they records which he made at the time of the gifts?

The Witness: These here on here are records that I made off and on at the time I gave them.

The Court: At the time you gave the gifts you made a record of the date you gave them and the——[16]

The Witness: Shortly afterwards. Not at the time.

(Testimony of M. J. Spiesman, Sr.)

The Court: I mean, it isn't something you have gotten together and put down from recollection in the last year or two or three years, is it?

The Witness: No.

The Court: It is records that you made substantially contemporaneous with the time when you made the gifts, is that it?

Mr. Andersen: Your Honor, I don't think he understands you. He made gifts and he has filed——

The Court: He seems to have understood.

Mr. Andersen: May I make one statement? He has filed gift tax returns on the gifts in excess of \$3,000 but they were not filed on time, your Honor, they were filed, I believe, in 1953, and I believe the Court should know that.

The Court: I wanted to know if the notes he is looking at for the purpose of testifying from them at the present time are notes that have been gotten together for the purpose of this trial or whether they are records of events that took place, records made at the time or substantially at the time when the transactions took place.

The Witness: These records——

Mr. Andersen: Your Honor, the record, either in stock certificates or the deeds of the property, are what he took that from. [17]

The Court: All right, you go ahead with your examination. Those matters have a little bit to bear upon the weight to be given testimony, but there has been no objection to your proceeding as it is, so go ahead.

(Testimony of M. J. Spiesman, Sr.)

Q. (By Mr. Andersen): The gifts you have made to your son?

A. That was real estate, I made a gift of a house, lot 11, block 2, original, in the townsite.

Also, before I made him that gift, I had to fix it up and put a little extra money on it, and one thing and another.

Q. We are only interested in the type of property you gave him and the date you gave it to him or the approximate date.

A. That was in 1943, that I made him that gift.

Q. Have you made any other gifts after that?

A. After that, why—well, on July 1, 1940, I gave him another building next to it.

Q. Would you look at that and—would look at the date. I don't believe you gave the right date.

A. What?

Q. I don't believe you gave the right date.

A. July 1, 1945, that I gave him the other house, and it was situated right next to the first one that I gave him.

Q. And what other gifts?

A. And it was some time, quite a while, before I made [18] any more gifts to him. On January 14, I believe, I gave him 500 of Bunker Hill to give to Jimmy.

Q. You didn't give the date, though, as to the year.

A. Oh, that was January 14, 1946.

Q. You gave 500 Bunker Hill?

A. Yes.

(Testimony of M. J. Spiesman, Sr.)

The Court: What do you mean by that?

Q. (By Mr. Andersen): Five hundred shares of Bunker Hill & Sullivan Mining Company stock?

A. Yes.

The Court: You gave that—I didn't get it clear who he gave it to. To his son?

Mr. Andersen: To his son.

The Court: All right.

Q. (By Mr. Andersen): Did you make any further gifts to your son?

A. Not that I know of. I have no——

Q. How about 1955?

A. I already told about that.

Q. '45 you gave us, but not '55. A. 1953?

Mr. Basye: Respondent can't tell whether the witness is answering the questions from his own independent knowledge or not. I hate to interpose an objection just on the ground [19] of leading the witness, but——

The Court: Well, with respect to the last question, the year 1955 is not involved in this case. Why are we bringing that out?

Mr. Andersen: Just to show his pattern of making gifts at all, distributing his estate.

The Court: There is no need to go into 1955 because it is not involved.

Mr. Andersen: All right.

Q. (By Mr. Andersen): Have you made other gifts?

A. I have made gifts to the children.

(Testimony of M. J. Spiesman, Sr.)

Q. Would you tell the Court who you made the gifts to and when?

A. I can by looking at the records. I will have to go over the records and find it.

In 1945 I gave Leonard John 400 Bunker Hill & Sullivan stock and a hundred Sunshine. And in 1945 I gave——

The Court: Just a moment. When you just say “Bunker Hill & Sullivan” and “Sunshine” it doesn’t mean too much to the Court. Maybe I have an idea of what you are talking about, but I want a record here so other people will know. I know what Sunshine Mining Company is and what Bunker Hill & Sullivan Mining Company is, but that isn’t a good record. It might be some other kind of Sunshine. [20]

Q. (By Mr. Andersen): Would you——

A. In 1945 I gave Leonard John 400 Bunker Hill & Sullivan Mining stock and 100 of Shine. In the same year, 1945, I gave Leonard John 400 Bunker Hill & Sullivan Mining Company stock and 100 Sunshine Mining Company stock. And in ’45, the same year, I gave Michael Joe 400 Bunker Hill & Sullivan Mining stock. And in 1946 I gave Phillip James 400 Bunker Hill Mining stock and 100 shares of Sunshine Mining stock. And in 1946 I gave Michael Joe a hundred shares of Sunshine Mining stock. And in ’46 I gave Leonard John Spiesman a hundred shares of Sunshine Mining stock. And in 1951 I gave Mathew James 300 shares of Sunshine Mining and in 1951, in December, I gave the five

(Testimony of M. J. Spiesman, Sr.)

kids—all five of them—thirty-five ninetieths (35/90) of my, 35/90 of the equipment of Spiesman & Spiesman.

Mr. Andersen: I think I will stop him there, your Honor, because these other gifts are after the years in question.

The Witness: Here is another notation, in '55, that I gave my son 100 shares of Homestake Mining Company stock and 100 shares of Hecla.

Q. (By Mr. Andersen): That was your son, but that was not involved, so——

A. No, I understand now that that is not involved anyway.

Q. What was the purpose of, Mr. Spiesman, you making [21] these gifts to your son and grandchildren?

A. Just a moment. Does it make any difference about other gifts, besides the mining stock? I did give—well, I don't know what year that would be, but I gave them——

Mr. Andersen: I think I would like to get this in.

A. (Continuing): ——to Francis Edward and Mathew James—I don't know what year it was.

Q. What year did you give them——

A. I gave them a mortgage on the house, the mortgage was for \$10,000.

Q. You gave each a \$5,000 interest in the mortgage? A. A half-interest in the mortgage.

Q. Would you give the year that you did that?

A. I don't know. I don't know if I marked that

(Testimony of M. J. Spiesman, Sr.)

down or not. I took some notes from the records, to find out.

Q. Well, that is afterwards anyway. Let's pass it.

A. Well, here it is. It's 1953, I gave Mathew James a third, one-half interest in the Chase mortgage, its value, mortgage value, was \$10,000, so I gave each of them a half-interest, to him, and the other half to Francis Edward.

Q. So that they each had a \$5,000 interest in that mortgage?

A. Each \$5,000 in that mortgage.

Q. What was the purpose of making gifts to your son and grandchildren? [22]

A. Well, the purpose of making all these gifts to my grandchildren was that I am getting pretty old, and I figured to dispense with a lot of legal work or anything else and give what I had to where it belonged, to the children mostly.

Q. Mr. Spiesman, in your gifts had you made any attempt to try and equalize the gifts—I call your attention to the fact that on the first gifts there were two of the children who weren't in existence yet at that time. Would you explain that to the Court?

A. That was probably the reason, that would be the reason, that was the reason that I gave some of the stock, I believe 500 shares of Bunker Hill, to my son to be given those children later, or in case. And I also, as time went on, I could see where things weren't being equal, stocks were fluctuating, some was going up and some was going down, and I tried to speak to him and see if he could equalize them

(Testimony of M. J. Spiesman, Sr.)

things, I tried to keep all of the children equal. And, in addition to that, when I made my will out—that will isn't here as evidence, I don't suppose I can show it, but I did have it in there, what I had left should go to the children, to make them all as equal as possible, to equalize all that I had left.

Q. What you meant by "equal," you wanted each one of the children to have 400 Bunker Hill and perhaps so many Sunshine and—is that the way you had it figured?

A. Not too much that, no. I wanted them to equalize [23] it in value, that is, if the four hundred shares of Bunker Hill was down to 10 and the Sunshine was up to 20, I wanted the rest of my estate to equalize that stuff with them, that is, to equalize them all, where they would all be worth the same amount of money, by taking what I had left and dividing it that way.

Q. And that was as to your five grandchildren?

A. That was as to my five grandchildren.

Q. Mr. Spiesman, I hand you a U. S. News & World Report dated October 5, 1951, and ask you to turn to page 68 and tell me what this is (indicating).

Mr. Basye: Your Honor, we will stipulate that that is the U. S. News & World Report, but I think that the magazine speaks for itself, what it says in there. I don't see any purpose of counsel's—

The Court: I think it does identify itself. You have identified it.

Mr. Andersen: Yes. Then I would like to intro-

(Testimony of M. J. Spiesman, Sr.)

duce it in evidence, but I would like to ask him a few questions about it.

Mr. Basye: We have no objection to him introducing it in evidence, your Honor. I just think that the magazine speaks for itself.

The Court: You do not object?

Mr. Basye: No, sir. [24]

The Court: Are you offering this magazine?

Mr. Basye: I am not offering it.

The Court: Are you offering this magazine in evidence?

Mr. Andersen: Yes, your Honor.

The Court: For what purpose?

Mr. Andersen: For the reason that this is where the gentleman first got his idea for starting a family partnership, and this relates to an enactment of the new law liberalizing the family partnership rule.

The Court: Can't you get at that without introducing a magazine?

Mr. Andersen: I suppose I can. I will go ahead then. But I thought it might be important that the Court see the magazine article.

The Court: Well, don't introduce the magazine, in any event. I don't want to have to read or look at the whole magazine. Can you refer to any specific article on a definite page of it and offer that portion of it only, if that is what you are going to offer?

Mr. Andersen: Yes.

The Court: Let's make your offer before you go on into the evidence. I understand there is no objection to it. Offer it in evidence, the article, and de-

(Testimony of M. J. Spiesman, Sr.)

scribe what it is. That is the only part we are going to take in evidence. [25]

Mr. Andersen: I offer an article in the U. S. News & World Report, dated October 5, 1951, at page 68.

The Court: And the article is entitled what? Is it all on the one page?

Mr. Andersen: The article is entitled——

The Court: Is it all on the one page?

Mr. Andersen: No, your Honor. It covers 4½ columns.

The Court: Then I suggest that you cut it out of the magazine, paste it on a piece of paper and offer it that way.

Mr. Andersen: Your Honor, I have a photostatic copy.

The Court: And set forth the date, month and so forth, and the name of the magazine. Then the Clerk may stamp it as an exhibit. Right now let's consider that the offer is withdrawn and you will prepare the exhibit in proper form for submission. Go ahead and examine on it if you wish.

Mr. Andersen: Yes. I have a photostatic copy of this here that I could——

The Court: Of just the article?

Mr. Andersen: Yes. It will take me a second to find it.

Mr. Basye: I have a copy of it.

Mr. Andersen: This article is called "Partnership [26] Within Family May Save Tax."

Q. (By Mr. Andersen): Mr. Spiesman, did you

(Testimony of M. J. Spiesman, Sr.)

read this article? A. Yes.

Q. And could you tell me what your impression was when you read this article.

A. At the time I was giving my estate, you might say, away to the children, and I owned a 50 per cent interest in Spiesman & Spiesman, and I thought it would be a good idea to give that away to the children, too, if it could be formed into a partnership, and I asked my son what he thought of it and his idea about it, and in that way that was, as I, as close as I can figure it, the starting of the idea of the family partnership, it was obtained from that article.

Q. Did you do anything at that time with regard to starting a family partnership?

A. Yes. I believe I suggested to my son that he get busy, after he thought it was all right, and I believe that he did get busy—at least he made a trip to Boise to see some of the tax experts, or the tax people anyway—and see if it was all right to do that, and I believe then we got a favorable reply anyway, because we did——

Mr. Basye (Interrupting): I object to that, your Honor. I don't think the witness has any independent knowledge of what his son—— [27]

The Court: I sustain the objection.

Mr. Andersen: You can't answer that part of it.

The Witness: What?

Mr. Andersen: I say, he won't allow you to answer that part of it, because it is not directly responsive to the question.

(Testimony of M. J. Spiesman, Sr.)

Q. (By Mr. Andersen): At that time, you stated that you had 50 per cent ownership in the assets of the Spiesman & Spiesman partnership.

A. Yes.

Q. Can you tell me in substance what the terms of that agreement were?

The Witness: I am hard of hearing, Judge. I don't get him until he gets closer.

The Court: Step a little closer to the witness.

Q. (By Mr. Andersen): Could you tell me in substance what the terms of the agreement were between your son and yourself? A. Roughly, yes.

Mr. Basye: Your Honor, I would like to inquire whether there is a written agreement or an oral agreement. He hasn't identified what——

The Court: Was that an agreement in writing?

The Witness: Yes. [28]

The Court: All right, he has answered it.

Mr. Basye: Are you going to offer this in evidence?

Mr. Andersen: Yes.

The Court: Before you proceed, Mr. Andersen, the Clerk has to get some numbers marked here. You already have one offer of an exhibit. Can we——

Mr. Andersen: Get that marked?

The Court: Can we get that marked so that we can keep the thing orderly here?

Have you any objection to that being clipped out of that magazine?

Mr. Andersen: No, your Honor.

The Court: Then let the Clerk stamp the first

(Testimony of M. J. Spiesman, Sr.)

page of it, and we will put it up to the Clerk to clip the other columns out of it and mark it as your exhibit.

Mr. Basye: I might be able to help him in that regard. I think this might be a photostat of that article.

The Court: That would be very convenient.

The Clerk: Is this the one you are going to submit now, this photostat, as an exhibit.

Mr. Andersen: I ask that that be introduced and marked in evidence as Petitioner's 8.

The Court: Now, you are referring to the article which appeared in the October 5, 1951, issue of the U. S. [29] News & World Report?

Mr. Andersen: That is right.

(Petitioner's Exhibit No. 8 was marked for identification.)

The Court: It is being offered in evidence as Petitioner's Exhibit No. 8, correct?

Mr. Andersen: Yes, that is correct.

The Court: It will be received in evidence, since there is no objection on behalf of the respondent.

(Petitioner's Exhibit No. 8 was received in evidence.)

Q. (By Mr. Andersen): You didn't answer my question as to what the substance of your agreement——

Mr. Basye: I object, your Honor. If there is a written agreement, the agreement speaks for itself.

(Testimony of M. J. Spiesman, Sr.)

It hasn't been offered yet. I don't know whether his name as a party appears on the agreement.

The Court: I will sustain the objection at this time.

All we have in the record is that there was an agreement between Mr. Spiesman, Sr., and his son, Mr. Spiesman, Jr., and that it was in writing .

Mr. Andersen: I offer this written agreement in evidence. I want to make one inquiry on it first before I offer it. [30]

The Court: Let me help you. Just stand where you are. I understand this is the first case you have tried before the Tax Court.

Mr. Andersen: Yes, sir.

The Court: Let me suggest that when you have an exhibit to offer you hand it to the Clerk, ask him to mark it for identification, and he will mark it and hand it back to you. Then get it identified, or if there is an agreement on it it can be marked, offered in evidence at that time, and then it is marked as an exhibit received in evidence.

Mr. Andersen: Thank you, your Honor.

The Court: But first it has to be identified so we will know what we are talking about.

The Clerk: This is Petitioner's Exhibit No. 9, so marked for identification.

(Petitioner's Exhibit No. 9 was marked for identification.)

The Court: Now, hand it to the witness and ask him if that is, the agreement or the document which

(Testimony of M. J. Spiesman, Sr.)

has been marked Petitioner's Exhibit No. 9 for identification, whether that represents the agreement between the witness and his son, to which he previously testified.

The Witness: I will look and see if I signed it.

The Court: All right, look back and see. You are the one who has to identify it.

The Witness: This is the agreement. [31]

The Court: Now, then, if you want to offer it in evidence, offer it.

Mr. Andersen: I want to ask one question.

Q. (By Mr. Andersen): There has been some alterations or writing, I don't know whether you would call them alterations, but I ask you if this amount of sixteen sixty-four fifty is your handwriting.

A. Yes, sir, it is.

The Court: It isn't in evidence as yet.

Mr. Andersen: I offer this agreement in evidence.

Mr. Basye: I would like to take a look at the document, your Honor.

The Court: Very well.

Mr. Basye: In aid of a possible objection, may I inquire of the witness?

The Court: Yes.

Q. (By Mr. Basye): I ask you, Mr. Spiesman, whether this writing that appears on the face of Petitioner's Exhibit 9 for identification was made in your handwriting at the time the document was signed by you, or was that put on the document after you had signed it originally?

(Testimony of M. J. Spiesman, Sr.)

A. Which one do you mean?

Q. Or do you remember?

A. Which one do you mean? [32]

Q. This is a petitioner's exhibit for identification, No. 9, which I hand you. Just that pen-and-ink marking on the face of the instrument.

A. Well, the pen-and-ink marking was wrong, and what I paid was \$1,664, or half of it, for my share of the equipment.

The Court: Mr. Spiesman, when you put that handwriting, that writing that appears in ink there, on there?

The Witness: I put it on there directly after; as soon as this was written out to me and shown to me, I said "It's wrong."

The Court: Did you put it on before you signed it?

The Witness: I don't remember that.

The Court: What is the date of the agreement?

The Witness: The date of the agreement is October the 8th, 1956.

Mr. Andersen: That is the identification number.

The date of the agreement would be——

The Court: When did you execute it, when did you execute that?

The Witness: It was in February, 1st day of February, 1950.

The Court: February 1, 1950. Now, then, were those changes or what you have described as changes, which appear on the first page in ink, were they put

(Testimony of M. J. Spiesman, Sr.)

on there prior to the time you signed this, on February 1, 1950, or after? [33]

The Witness: Well, I don't remember now, but I know that when it was read to me the mistake was here, this mistake was made, and I put that in there.

The Court: And you had to make that change before you would sign it?

The Witness: Well, I don't know whether I signed it before or after.

The Court: Well, was it done at the same time, on the same occasion?

The Witness: It was done, I believe, on the same occasion.

The Court: Same day, at the time you were looking it over, reading it?

The Witness: As I got it, at the time I got it, I looked it over and saw this was, I seen these were wrong, that I had paid this much, not this much, but the half of this much, \$1,664 was the value of the machine, and half of it was what I paid.

The Court: Does that satisfy you?

Mr. Basye: Yes. He still hasn't offered it in evidence, your Honor.

The Court: Yes, he has made the offer. You asked to ask qualifying questions.

Mr. Basye: I have no objection to the document.

The Court: Petitioner's Exhibit No. 9 will [34] be received in evidence.

(Petitioner's Exhibit No. 9 was received in evidence.)

(Testimony of M. J. Spiesman, Sr.)

Mr. Andersen: May I ask him some more questions about this?

The Court: Yes.

Q. (By Mr. Andersen): Would you state the important substance as to this agreement, that is, as to the ownership and distribution of earnings?

A. Well, in the distribution of earnings, Mathew J. Spiesman was to get——

Mr. Basye: I think the instrument so states. I object.

The Court: Does the instrument so state?

Mr. Andersen: Yes, your Honor.

The Court: Then, the instrument is the best evidence on those points. I will sustain the objection.

Mr. Andersen: I ask that this be marked for identification as Petitioner's Exhibit No. 10.

The Court: The Clerk will give it a number. You just ask him to mark it for identification.

Mr. Andersen: Yes, your Honor.

The Clerk: Petitioner's Exhibit No. 10, so marked for identification.

(Petitioner's Exhibit No. 10 was [35] marked for identification.)

Q. (By Mr. Andersen): I hand you Petitioner's Exhibit No. 10 and ask you to look at it and tell me what it is.

A. What was the question, whether this was the agreement?

Q. What is that agreement?

(Testimony of M. J. Spiesman, Sr.)

A. This is the agreement for Spiesman & Sons, wherein we took the children into partnership.

Q. Took your five grandchildren into the partnership? A. Yes.

Q. Mr. Spiesman, I call your attention to some writing on this sheet, up there at the top, it's written over "Michael James"; that correct name is "Michael Joseph," is it not? A. What is this?

Q. The original document has been marked "Michael James," and it has been corrected to "Michael Joseph"?

A. Michael Joseph is right.

Q. Mr. Spiesman, there are some other alterations on this agreement. Would you explain to the Court——

A. There is one in here, wherein after reading it, I see where they had, at the time—shall I read it?

Q. You may read that clause if you wish.

A. "At the time of this agreement the assets to be [36] taken over by the partnership are in the possession and owned by the partners, Mathew James Spiesman, Jr."—and then my name was left out—"in the value of \$2,347.63." So my name being marked out, I owned half of the assets of Spiesman & Spiesman, that was being turned over, and there was a mistake made there, where it said above "the partners," in an oversight my name wasn't put in. And it seems like that there is——

Q. Who made the correction?

A. Well, I called attention to the fact and made the correction, and that ain't my writing, though.

(Testimony of M. J. Spiesman, Sr.)

Mr. Basye: I didn't hear the answer of the witness, your Honor. What was the last statement of the witness?

The Court: "I called attention to the fact and made the correction, and that ain't my writing, though."

A. (Continuing): It looks like Bud's writing. If the Judge would take a look at the two together, he could——

Mr. Andersen: He is probably not interested.

Q. (By Mr. Andersen): Would you tell us what the purpose of your name on the margin there is?

A. The purpose of my name on the margin was to make this OK that this here was put in, as I understand it. That's the reason I put it on the margin.

Q. Mr. Spiesman, would you tell the Court whether or not that was put on there at the time of the writing or at the [37] time shortly after they started making their examination of Bud, your son Bud?

A. Well, that is when I noticed the discrepancy there, was then.

Q. You didn't notice it at the time you signed the agreement?

A. No, I did not.

The Court: What do you mean, at the time they started making the examination?

Mr. Andersen: Not at the time they started to make the examination, but after the examination had been, you might say.

The Court: Are you referring to an examination by the Internal Revenue Bureau?

(Testimony of M. J. Spiesman, Sr.)

Mr. Andersen: That is right.

The Court: Then, as I understand the witness——

That marginal notation of your name was made on that document, which has been identified as Petitioner's Exhibit No. 10, after the agents of the Bureau of Internal Revenue or the Internal Revenue Service began examining your son's income tax affairs?

The Witness: I looked up this agreement and found out my name wasn't on there, that only his name was put in there, yes.

Q. (By Mr. Andersen): [38] Mr. Spiesman, this agreement had been recorded? A. Yes.

Q. And this alteration was after the recording?

A. Yes.

Q. And it was in more or less of a memorandum form? A. Yes.

Mr. Andersen: Your Honor, we offer this in evidence, not as the recorded instrument, but as an instrument indicating their contract of agreement.

Mr. Basye: In order to aid myself in a possible objection to the instrument, I wonder if I could ask the witness one question, your Honor.

The Court: Very well.

Q. (By Mr. Basye): You stated that the change in the instrument, Mr. Spiesman, I believe, was not in your handwriting. Is that right?

A. If you will look at both of those together, they are so close together that I wouldn't swear to my own handwriting and his.

Q. But is your name signed, is that your signa-

(Testimony of M. J. Spiesman, Sr.)

ture on the instrument? Is that your signature there? A. Yes.

Q. One other question was, that you didn't discover this error, or you didn't change the instrument until some time—— [39]

A. (Interrupting): I didn't discover it until I read it carefully over afterward and seen that there was a mistake made there and I wasn't put in as a half-owner of Spiesman & Spiesman, which I actually was.

Mr. Basye: Any other objection or argument on this will have to be on cross-examination. I withdraw any objection to the introduction of this at this time.

The Court: Petitioner's Exhibit No. 10 will be received.

(Petitioner's Exhibit No. 10 was received in evidence.)

Q. (By Mr. Andersen): Mr. Spiesman, you were examined at the same time, were you not, that your son was examined, for the years of '51 and '52?

A. Yes.

Q. And did they make any changes on your report? A. No.

Q. They accepted your report as filed?

A. Yes.

Q. I ask you, Mr. Spiesman, did you report one-third of the income of the partnership of Spiesman man & Sons for the period from December 1, 1951, when it was organized, to December 31, 1951?

(Testimony of M. J. Spiesman, Sr.)

November 30, 1951, when the partnership was ended? A. Yes. [40]

Q. Spiesman & Spiesman partnership was ended? A. Yes.

Q. I ask you, Mr. Spiesman, if you reported one-ninth of the income from this partnership of Spiesman & Sons for the period from December 1, 1951 when it was organized, to December 31, 1951.

A. Yes.

Mr. Basye: I object, your Honor, on the ground that we already have in evidence the partnership returns, and this man is not a petitioner in this proceeding. I don't see how it's relevant whether he reported it or not. It is on the partnership returns which are already in evidence.

The Court: The partnership returns are in evidence?

Mr. Basye: Yes, subject to stipulation.

The Court: And the reporting of the income is done on those partnership returns. Are his returns in evidence?

Mr. Basye: Are his returns in evidence? They are not.

The Court: As one of the exhibits attached to the stipulation?

Mr. Basye: They are not.

Mr. Andersen: My only point in bringing this out was that we are alleging that he made gifts of this income-producing property, of which this partnership is part, and I wanted to call attention to the

(Testimony of M. J. Spiesman, Sr.)

fact that they have not been [41] back and given or assessed any of the income to him but have left it all to the father, and that is my only point in bringing that out.

The Court: I will sustain the objection to the question.

Q. (By Mr. Andersen): At the time you were being examined did the examining officer ever explain to you why he disallowed the 1/9 interest of the income shown by the five children——

A. What was that question?

Q. Did the examining officer—that would be Mr. Straub—ever explain to you why he disallowed the 1/9 interest in the income of your son?

A. No.

Mr. Basye: I object, your Honor.

The Court: I sustain the objection.

Q. (By Mr. Andersen): Besides keeping the 1/9 interest in the partnership when you organized the firm of Spiesman & Sons, did you ever make any further contributions of capital to that partnership?

A. Yes.

Q. How much and when?

A. Well, I gave a hundred dollars to start a new capital after the capital of Spiesman & Spiesman was withdrawn. [42]

Q. You gave working capital to it?

A. Then I put in \$100. And whether the question goes further that the rest of them was supposed, whether the boys was supposed to put in a hundred

(Testimony of M. J. Spiesman, Sr.)

dollars and Mathew, Jr., why, he put in the rest to make a thousand dollars.

Q. He was only supposed to put in nine hundred, wasn't he?

A. Well, yes, but he put in an extra hundred, I believe.

Q. Is this partnership still in existence, Spiesman & Sons? A. Yes.

Q. Mr. Spiesman, are you anticipating putting any further capital into this partnership?

A. Yes.

Mr. Basye: I object.

The Court: I sustain the objection.

Q. (By Mr. Andersen): Mr. Spiesman, do you know anything about bookkeeping? Have you had any bookkeeping experience? A. Very little.

Mr. Andersen: Your witness.

The Court: Cross-examine.

Cross-Examination

By Mr. Basye:

Q. Mr. Spiesman, on your direct examination you testified [43] to certain gifts that you had made to your son, covering the period, I think, '38 thru '46. I ask you whether the gift to your son that you made in 1938 was, in the form of money, was to buy a business? A. Yes.

Q. And what was that business?

A. That was my old business that I had been in since 1911.

(Testimony of M. J. Spiesman, Sr.)

Q. And you had sold that business to someone else?

A. I had sold that business to another party, and that party put a price on it and offered to sell it back, and I bought, or gave 23 hundred dollars, or something like that——

Q. To your son?

A. I think it was \$2,375, to buy a half-interest, with another person named Resor.

Q. You had no interest in this business that your son used the money for? A. No.

Q. You then testified, I believe, Mr. Spiesman, concerning gifts that you made to the grandchildren.

A. Yes.

Q. Now, these gifts consisted of stock?

A. Yes.

Q. You mentioned certain shares of stock.

A. Yes. [44]

Q. I would like to know how you made these gifts. What evidence is there of the gift—I will ask you one specific question. Did you own stock certificates which you gave to the children and had them transferred in their name?

A. I owned the certificates, at Merrill, Lynch, Pierce, Fenner & Beane, and they were transferred to the children.

Q. I see. You didn't give them money or anything like that? A. No; I gave them the stock.

Q. You also stated that you have made gifts of a certain real estate mortgage that you held.

A. Yes.

(Testimony of M. J. Spiesman, Sr.)

Q. I want to know how you made that gift. What evidenced that gift?

A. Well, I had built the house, and the price of it was 13 thousand and some-odd dollars, it was for sale. I never did sell it. It was tough to get money from the bank at home for a G.I. mortgage, they just didn't seem interested in them kind of things, so it hung on for quite awhile and finally this man Chase offered to buy the building, the home, and wanted to know the price of it. I told him, I believe it was 13 thousand five hundred, and he paid the 3 thousand, or whatever the odd money was anyway. It left a mortgage for \$10,000, and that mortgage I turned over to my two grandchildren, Mathew James, Jr., Sub-Junior, whatever you would [45] call it——

Q. The Third (III)?

A. Yes. And Francis Edward.

Q. Those are grandchildren of yours?

A. Yes.

Q. The specific question I asked you was how you turned it over to them. How did you turn it over to them?

A. I turned the mortgage that Chase gave me over to them, through a real estate office.

Q. You made an assignment of that?

A. That is right.

Q. Do you have a copy of that here in Court?

A. Yes.

Q. Is it a recorded document?

(Testimony of M. J. Spiesman, Sr.)

A. Yes. It should be, at the courthouse in St. Maries.

Q. You also testified, Mr. Spiesman, that then you wanted to give away an interest that you had in the Spiesman & Spiesman partnership.

A. Yes.

Q. I ask you specifically, how did you make the gift of what interest you had in that partnership?

A. Well, I had a common denominator some way, I had to have a common denominator, of some way to divide it evenly amongst the children, and that seemed a tough thing to do unless I stayed in, so I took the, we took the, or I did, the [46] denomination was 90th, that is, I owned 45/90ths of Spiesman & Spiesman, so I gave 35/90ths to the children and kept 10.

Q. And how was that evidenced, Mr. Spiesman?

A. What?

Q. What did you do, did you draw up any papers on that? Did you make an assignment of an interest?

A. Yes, certainly I did.

Q. What——

A. I gave it to—it's in the evidence there, ain't it, that paper?

Mr. Basye: I ask for Petitioner's Exhibit 10.

A. You asked how I divided it?

Q. With respect to the last question I asked you, is this the way you made the gift to the children of your interest in Spiesman & Spiesman, a partnership, by entering into that partnership agreement

(Testimony of M. J. Spiesman, Sr.)

which is identified in evidence as Petitioner's Exhibit 10?

A. That is right. And to get that 1/9 I had to use 90ths. I put in——

Q. (Interrupting): You have answered the question, Mr. Spiesman. I haven't asked you any more questions yet.

A. Oh. I was going to explain how it come out.

Q. Just one more question, Mr. Spiesman. That was that the article which has been submitted as Petitioner's Exhibit 8, you testified that that was the reason that you [47] decided to form a family partnership with the children. Is that right?

A. I stated that it was the reason. There may be some misconception there, but that was——

Q. Just explain.

A. It was what gave me the idea.

Mr. Basye: No other questions.

Mr. Andersen: No further questions, your Honor.

The Court: I believe you stated that your reason was that you yourself were getting old and you wanted to——

The Witness: Well, that was the reason, but he put it in a different way, and the paper was what gave me the idea.

The Court: Your reason was that you were——

The Witness: That is it.

The Court: You felt you were getting old and you wanted to distribute your property to your children and grandchildren before you died?

(Testimony of M. J. Spiesman, Sr.)

The Witness: And I got the idea from that magazine.

The Court: All right. Anything further?

Mr. Andersen: I have nothing further, your Honor.

The Court: Stand aside, Mr. Spiesman.

(Witness excused.)

The Court: We will have a five-minute recess.

(Short recess.)

The Court: The court will be in session. [48]

Mr. Andersen: We will call Bud Spiesman.

MATHEW J. SPIESMAN, JR.,
was called as a witness on behalf of himself, the petitioner, and, having been fully duly sworn, testified as follows:

The Clerk: Would you state your name, please.

The Witness: Mathew J. Spiesman, Jr.

Direct Examination

By Mr. Andersen:

Q. What is your nickname? A. Bud.

Q. Mathew J. Spiesman, Sr., Heinie, is your father, isn't he? A. That is right.

Q. Are you married? A. Yes.

Q. How many children do you have?

A. Five.

Q. Are they the same children named by your father as his grandchildren?

(Testimony of Mathew J. Spiesman, Jr.)

A. That is right, yes.

Q. Did your father start you out in business?

A. Yes.

Q. When? A. In 1938.

Q. Did your father also finance the Gem State Club? [49] A. Not entirely. About half of it.

Q. Did your father make any gifts of dividend-paying stock to your children? A. Yes.

Mr. Andersen: May we have this document marked, please.

The Clerk: Petitioner's Exhibit No. 11, so marked for identification.

(Petitioner's Exhibit No. 11 was marked for identification.)

Q. (By Mr. Andersen): I hand you Exhibit No. 11 and ask you what that is.

A. This is the guardianship papers on four of the children.

Q. That is a certified copy, is it not, filed with the probate court? A. Yes.

Q. And the children, four children, are whom?

A. Michael Joe and Phillip James, Leonard John and Mathew J.

Mr. Andersen: I ask this be introduced in evidence.

Mr. Basye: It appears from the face of the exhibit, your Honor, that this is a certificate certified by the Probate Judge in Benewah County, so I have no objection.

(Testimony of Mathew J. Spiesman, Jr.)

The Court: Petitioner's Exhibit No. 11 is received in evidence. [50]

(Petitioner's Exhibit No. 11 was received in evidence.)

Q. (By Mr. Andersen): Mr. Spiesman, would you tell the Court the circumstances under which you were appointed guardian of your children?

A. My father had given my children stock in the amount of 1,200 shares of Bunker Hill & Sullivan, and, I think, 500 shares of Sunshine, and the first dividend checks that came through were cashed, I signed them "M. J. Spiesman, Jr., parent," and then it was probably the next—you see, I don't cash these checks every three months, I keep them, sometimes I had them for six months, and then I would cash all of them at once—but the next one that came through from the Bunker Hill & Sullivan Company, they returned the checks as, because of improper endorsement, so I went to the bank and they said, "Well, you should be appointed guardian by the court and that will eliminate this trouble. Otherwise you will never be able to cash these checks. As they are, they were made out in the children's names, the stock certificates."

Mr. Andersen: May we have this marked, please.

The Clerk: Petitioner's Exhibit No. 12, so marked for identification.

(Petitioner's Exhibit No. 12 was marked for identification.)

(Testimony of Mathew J. Spiesman, Jr.)

Q. (By Mr. Andersen): I will hand you Exhibit No. 12 and ask you what [51] that is.

A. This is the guardianship papers on Francis Edward.

Q. Is that a certified copy? A. Yes.

Q. And it was filed with the probate court?

A. Yes, sir.

Mr. Andersen: I would like to introduce this as Petitioner's Exhibit No. 12 in evidence.

The Court: Petitioner's Exhibit No. 12 is received in evidence.

(Petitioner's Exhibit No. 12 was received in evidence.)

Q. (By Mr. Andersen): This one, Mr. Spiesman, is dated April 17 and the other one is dated, the last one, that is, Francis', is dated the 13th day of October, 1953. That is right, isn't it?

A. Yes.

Mr. Andersen: May I speak to counsel for just a moment, your Honor?

The Court: Certainly.

Mr. Andersen: Your Honor, I have the annual inventory and accounting, copies of which have been certified by the Probate Court of Benewah County, and I was wondering if I could offer them as just one exhibit. Or should they go in individually?

The Court: For what years? [52]

Mr. Andersen: They cover from the date of the accounting to——

(Testimony of Mathew J. Spiesman, Jr.)

The Court: You have reference to the guardianship accounting?

Mr. Andersen: Yes.

The Court: And these are certified copies of the accounts filed with the probate court in these two guardianship matters?

Mr. Basye: Actually I believe there are four separate——

The Court: There are five children, there are two separate guardianship papers that he is offering in evidence.

Mr. Andersen: Only four of the children were born by this time.

The Court: Are these papers with reference to the guardianship of the four children?

Mr. Andersen: Everything is filed in this accounting for all five children.

The Court: And picks up at the proper date with the fifth child?

Mr. Andersen: Yes, sir.

The Court: You want to offer those in evidence?

Mr. Andersen: Yes.

Mr. Basye: We might as well make it one exhibit, your Honor. [53]

The Court: How many of them are there?

Mr. Basye: I have no objection to marking them as one exhibit, but I want it understood that there is no certificate from the probate judge saying that all documents have been filed as of the time of the probate proceedings.

The Clerk: I will just take the ones that are clipped together.

(Testimony of Mathew J. Spiesman, Jr.)

Mr. Andersen: There is the year of—you see, I thought it would expedite the——

The Court: Then wait just a moment. Put them in an envelope or staple them together, some way that they will keep together, mark it as one exhibit and offer it in evidence as the one exhibit, the documents relating to the accounts filed by the guardian, the guardianship accounts filed with the probate court, treat it as one exhibit.

The Clerk: This will be Petitioner's Exhibit No. 13, so marked for identification.

(Petitioner's Exhibit No. 13 was marked for identification.)

The Court: Staple them together, please.

Mr. Andersen: Yes, your Honor.

The Court: You can do that during the noon recess.

Are you offering those in evidence now?

Mr. Andersen: Yes, your Honor.

The Court: Any objection? [54]

Mr. Basye: No objection, your Honor.

The Court: Petitioner's Exhibit No. 13 will be received in evidence, consisting of a number of accounts filed by the witness, by the guardian, Mathew J. Spiesman, Jr., with the probate court with respect to his wards, the five children named.

(Petitioner's Exhibit No. 13 was received in evidence.)

Q. (By Mr. Andersen): In the preparation of

(Testimony of Mathew J. Spiesman, Jr.)

the account, did you have any accountant help you in the preparation of these accounts?

A. Kenneth Esmay.

Mr. Andersen: I offer in evidence order settling inventory of account and reported guardian, dated November 12, 1953.

The Court: Have it marked.

Mr. Andersen: For identification.

The Clerk: Petitioner's Exhibit No. 14, so marked for identification.

(Petitioner's Exhibit No. 14 was marked for identification.)

Mr. Andersen: We tried to stipulate this, but could reach no agreement, your Honor.

The Court: Petitioner's Exhibit No. 14 will be received in evidence.

(Petitioner's Exhibit No. 14 was received in evidence.) [55]

Q. (By Mr. Andersen): I hand you Exhibit No. 9 and ask you if you and your father were partners of Spiesman & Spiesman? A. Yes.

Q. And that partnership ended on December 1—or I mean November 30—1951?

A. That is right.

Q. And at that time did your father and you own the equipment equally? A. Yes.

Q. I hand you Petitioner's Exhibit No. 10, which is the partnership agreement of your father and yourself and your children, and ask you if at the

(Testimony of Mathew J. Spiesman, Jr.)

moment before you formed that partnership you and your father owned the equipment equally.

A. Yes.

Q. There has been a correction on there, and I will ask you if you made the correction.

A. I wrote this in on the top line, I didn't know there was a mistake in this document until Mr. Straub came along in this case——

Q. But I mean, is it correct as your father has identified it? A. It was corrected then.

The Court: You have identified this as Petitioner's Exhibit for identification No. what? [56]

Mr. Andersen: No. 10.

Q. (By Mr. Andersen): That is your signature on the lefthand corner? A. Yes.

Q. And you have made the corrections?

A. And that is my father's signature down below——

Q. Your father has testified that that was made after the examination—— A. That is right.

Q. Under the terms of this agreement, then, you were to receive one-third, you were to receive a salary of \$250 a month and receive one-third of the profits thereafter and your five minor children——

A. One-ninth.

Q. And your father one-ninth——

Mr. Basye: I will object, your Honor. The document speaks for itself.

The Court: I will overrule the objection. It is in.

Q. (By Mr. Andersen): And in the gifts you received from your father did you receive from him

(Testimony of Mathew J. Spiesman, Jr.)

by any instrument conveyance the interest in the equipment to the children? It was just possession, was it not? In other words, you didn't give him a bill, he didn't give you a bill of sale or anything like that, he just turned over to you the equipment, his interest, and you [57] as guardian accepted it?

A. Yes—you mean on the stocks?

Q. No. I am talking about this partnership now, that Spiesman & Sons——

A. Spiesman & Sons? No, I didn't get, he turned his interest over to the five boys, and he made a gift return on it, I think.

Q. I understand that. But he didn't make a bill of sale or anything like that? A. No.

Q. Was possession of the property conveyed to the children then? A. Yes.

Q. As identified by this instrument, between you two people, you and your father? A. Yes.

Q. How much did your father give each child, can you tell the Court?

A. He owned 50 per cent of the equipment, and he gave them one—he kept one-ninth of, he kept one-ninth of his 50 per cent interest.

Q. One-ninth of the whole interest?

A. One-ninth of the whole, yes. And then he ended up with one-ninth, and I gave the boys all but one-third, I gave them, I kept one-third and gave, and had to divide it into [58] ninetieths to make it come out even.

Q. Then he would have had 45/90ths interest in the equipment. he kept 10/90ths.

(Testimony of Mathew J. Spiesman, Jr.)

A. And gave away seven.

Q. And the five children would have gotten seven-ninetieths apiece? A. Yes.

Q. Then it was your intention to convey to the children all but, that is, it would be 21/90ths, wouldn't it? A. I kept one-third.

Q. No, it would be 15/90ths?

A. I gave away 15/90ths.

Q. And the seven and the three would make a ten, which would be a ninth each, and so when the partnership was formed each one would own one-ninth interest in the equipment?

A. That is right.

Q. And that would be your father, M. J., Sr., and the five children, minor children?

A. And myself.

Q. And yourself would own a third, you and your wife? A. Yes.

Q. Mr. Spiesman, when your father gave you these stock certificates for the children as a gift to the children did you have the stock certificates transferred to their own name? A. Yes. [59]

Q. And they are accounted for reasonably correctly on the accounting made to the court?

A. Yes.

Mr. Basye: I object, your Honor, as to it being reasonably correct. The accountings are in evidence. It would be his opinion as to whether or not they are reasonably correct.

The Court: I will sustain the objection.

We will recess until 2 o'clock.

(Testimony of Mathew J. Spiesman, Jr.)

(Whereupon, at 12:30 o'clock p.m. the hearing was recessed until 2 o'clock p.m. of the same day.) [60]

Afternoon Session, 2 o'Clock P.M.

The Court: The Court will be in session.
I believe Mr. Spiesman, Jr., was on the stand.
Will you resume the stand, Mr. Spiesman.

MATHEW JAMES SPIESMAN, JR.
resumed his testimony as follows:

Direct Examination

(Continuing)

By Mr. Andersen:

Q. I will hand you Exhibit No. 8 and ask you if you have read that article? A. Yes, I have.

Q. I will ask you if you and your father discussed forming the partnership with your children as a result of reading that article.

A. Yes, my father called this to my attention, this article.

Q. Did you do anything else with regard to determining whether the article was——

A. Yes, I did.

Q. (Continuing): ——correct or not?

A. Yes, I did. I had quite an argument as to whether a citizen could interpret this article and do what it said and then I went to a lawyer and he

(Testimony of Mathew J. Spiesman, Jr.)

said, "I believe you can," but he didn't sound too sure.

Q. What was the lawyer's name? [61]

A. He said he would look it up.

Q. What was the lawyer's name?

A. Warnett & Crowley.

Q. Which one did you talk to?

A. Warnett. So when I went back home my father suggested I go down and see the Internal Revenue Department, so I did, but I was advised there that they didn't give advice, and they gave me a copy of the law on it and told me what to look up.

Q. That is, Section 191 and Section 3797.82.

A. I don't know the numbers, but I looked them up.

Q. Mr. Warnett was a former Supreme Court Justice here in Boise, Idaho?

A. That is the man, yes.

Q. Did he give you any advice?

A. He looked it up in the meantime, and, when I gave him the numbers, and he told me it was all right.

Q. And he advised you that the children could hold property and be a partner?

A. Either by gift or by purchase, yes.

Q. Mr. Spiesman, after you had talked to your attorney and found out that a child could be taken in as a partner you proceeded to form a partnership of Spiesman & Sons, which is the partnership that is now in existence, of Spiesman & Sons, is that correct? [62]

A. Yes, that is right.

(Testimony of Mathew J. Spiesman, Jr.)

Q. In forming this partnership, your father gave the children, through you as guardian, 5/90ths interest in the machinery, or in the equipment?

A. He gave 7/90ths. You see, we had to go to a common denominator, and we had to use the 90ths.

Q. And then you accepted the gift, as guardian?

A. Yes.

Q. From your father, for the children?

A. Yes.

Q. And then you also made a gift to the five children, did you not? A. I gave them 15/90ths.

Q. That would be 3/90ths each?

A. That would be, I gave them 15/90ths of my half interest—of the whole, yes.

Q. But I mean, you gave each child 3/90ths interest, that is the way it works out?

A. Yes, 3/90ths to each child, that is the way it works.

Q. So that each child had 10/90ths or one-ninth interest in the partnership? A. Yes.

Q. Your father had one-ninth, and you had a—— A. I had 3/9ths. [63]

Q. You had a third?

A. I had 3/9ths or one-third, yes.

Q. During the year of 1951, during which the Sons partnership only operated one month, did you take out a salary? A. Spiesman & Spiesman?

Q. No, Spiesman & Sons, for the one month.

A. Oh.

Q. Did you take a salary?

A. Yes, I believe I did, for the one month.

(Testimony of Mathew J. Spiesman, Jr.)

Q. The record shows that you didn't take anything. A. I am not certain.

The Court: He has to testify, or you must produce your records.

The Witness: I may not. The books of Mr. Esmay will clarify that point.

Q. (By Mr. Andersen): I hand you Exhibit No. 13 and refer to the item of profit and ask you if that is the amount of income each 9th received in 1951 from the partnership of Spiesman & Sons.

A. I believe that is right, I believe that is the right figure.

Q. I will ask you to look there and see whether they withdrew anything in 19——

A. (Interrupting): I don't see any withdrawals there.

Q. Well, there are no withdrawals? [64]

A. In '51.

Q. The amount of income that each one received here shows \$361.59 for each 9th; is that correct?

A. Yes.

Q. I ask you to further look at Exhibit No. 13 and ask you how much profit was shown by each 9th in 1952, for the full year, on the partnership of Spiesman & Sons.

A. Four thousand eight hundred forty-six dollars eighty-five cents.

Q. Mr. Spiesman, on Michael Joseph Spiesman it shows a withdrawal of \$1,593.25. On Phillip James Spiesman it shows—referring to the 1952 year——

A. 1952 income, the whole year?

(Testimony of Mathew J. Spiesman, Jr.)

Q. Yes. It shows a withdrawal of \$15.92 for Phillip James Spiesman——

A. Fifteen hundred ninety-two dollars, you mean.

Q. Fifteen hundred ninety-two dollars.

A. You said fifteen dollars.

Q. Fifteen hundred ninety-two dollars eighty cents. A. Yes.

Q. And Mathew James Spiesman, III, shows withdrawals of \$5,690.16. A. That is right.

Q. Leonard John Spiesman, it shows withdrawals of \$3,848.01. And Francis was fifty-nine hundred—— [65]

Mr. Basye: Your Honor, I object to this line of questioning. Is Mr. Andersen testifying here?

The Court: He is referring to the records and reading a figure and asking if that is correct.

Mr. Basye: One other, in the aid of objection, your Honor, is the fact that he is asking about withdrawals from a certain partnership, and apparently the record that he is referring to says that it is a guardianship account, and it seems to me that the best record of these withdrawals by the children is the partnership books and records.

The Court: You may cover that in cross-examination. I will permit the line of questioning at this time.

Q. (By Mr. Andersen): What I would like to have you explain to the Court is why the difference in the withdrawals; they were all equal ownership, but there was a difference in the withdrawals.

(Testimony of Mathew J. Spiesman, Jr.)

A. That is right.

Q. A considerable difference between the two oldest boys and the two youngest boys.

A. That is right.

Q. Would you explain that?

A. Your Honor, the difference in the amount of money withdrawn was due to the fact that Joe, the oldest boy, and Phil, the next oldest boy, had income from dividend stocks prior to the, and more stock, than the other children, and I [66] tried to even up—at that time I tried to even up the cash account of each child, so that if I had an accident, why, or I got killed or died, my youngest child wouldn't say, "Well, my dad wasn't very fond of me; he didn't leave me anything," and I didn't want to have that happen and I wanted them to be even as far as cash was concerned, and then they would eventually receive stock or whatever my dad was going to leave them when he died. But the cash account I tried to even up. It may have been wrong, but at that time I didn't know it.

Q. Did you subsequently make an adjustment, in a subsequent year, on your accounting?

A. I did, on this, in 1954. I think an adjustment is made, I am sure, I know it is, and the money that was withdrawn from, I mean the money that was held out of Joe and Phillip was credited to the three youngest boys, was returned to Joe and Phillip, the oldest boys.

Q. This money was in the bank, or cash on hand,

(Testimony of Mathew J. Spiesman, Jr.)

so that you had no trouble making the change back, of the money that had been expended?

A. Yes; it is in the safe deposit books, records.

Q. Mr. Spiesman, you accounted for all the income, I mean your income tax return showed the same account as was reported in your accounting?

A. Yes.

Q. Now, then, upon the audit of the return, they are [67] proposing to place all the income of the five children, for both years, that is, on to you?

A. They are, yes.

Q. This partnership is still in existence, this Spiesman & Sons? A. Yes; it is.

Q. Did you make any further contributions to the partnership for the children other than the 9th interest in equipment that was given to them? Was there sums put in the partnership as capital account?

A. Yes. We have increased the capital account to invest in phonographs.

Q. How much cash did you increase it by, and when? A. I believe it was \$500 each.

Q. Do you know what year that was?

A. I think that was 1954, I believe.

Q. At the time that the partnership was formed you had put in money for the children, as guardian, and you put in their own money, did you?

A. Yes.

Q. How much was it?

A. I put in \$100 apiece, but Francis didn't have a hundred dollars——

(Testimony of Mathew J. Spiesman, Jr.)

The Court: Mr. Spiesman, let me suggest you throw your chewing gum out. That interferes with your talking and our understanding you. [68]

The Witness: I am sorry, your Honor.

Q. (By Mr. Andersen): One hundred dollars each?

A. One hundred dollars each, and Francis had no income or stock then, at that time, and I put in \$100 for Francis and he subsequently paid me \$100 back.

Q. But all the other came out of their own money? A. Yes.

Q. And you did that as guardian for them?

A. Yes.

Q. Mr. Spiesman, what was the reason that you had to put the additional capital in in 1945?

A. Well, I had more locations for phonographs and these amusement games, and I needed, we needed to cover these locations.

Q. When was it that the coin-operated gaming devices became illegal or when they made them——

A. December 31, 1953.

Q. And then did you need any additional capital for pinball machines or anything like that?

A. Not at that time. Later.

Q. You had sufficient capital to take care of that?

A. A little later on, until a little later on, yes.

Q. So that now your business consists of, chiefly of, phonographs and pinball machines? [69]

(Testimony of Mathew J. Spiesman, Jr.)

A. It's amusement devices, these little pinball, pool tables and shuffleboards and phonographs.

The Court: What they call "jukeboxes"?

The Witness: Yes.

Q. (By Mr. Andersen): Do you know how much you took out in 1952 from Spiesman & Sons as salary?

A. I am sure it was \$2,400.

Q. That is what you actually withdrew?

A. Yes.

Q. Then the profits above that, then, were divided equally, according to the capital ownership?

A. That is right.

Q. And you said that the partnership is still in existence?

A. Yes.

Q. And I was going to ask you, how tall is your oldest boy now?

A. Six foot two.

Q. And he is only 16 years old?

A. Sixteen, yes.

Q. I ask you if he has shown any inclination to be in the business, that is, as a repairman or anything?

A. Yes; he has helped me off and on.

Mr. Basye: I object, your Honor, as [70] immaterial.

The Court: I sustain the objection.

Q. (By Mr. Andersen): Mr. Spiesman, how much time did you devote for the one month during which the operation was conducted in 1951 and the 12 months of 1952 in service, in performing your services as manager of the Spiesman & Sons partnership? How many hours per day would be the average?

(Testimony of Mathew J. Spiesman, Jr.)

A. An average would be about 3½ hours a day, 3 or 3½ hours a day.

Q. Could you have hired anyone else to do the work for the same amount of money?

A. I imagine, yes.

The Court: Is that in place of himself that you are speaking of?

Mr. Andersen: Yes.

The Court: All right. If you are through with that testimony, I want to get back to the line of testimony which was objected to and I sustained.

I understood you were talking about, now, your boy, who is now 16 years old, and that he is now showing an inclination to take part in the business.

The Witness: Your Honor, he has been——

The Court (Interrupting): Did any of your previous testimony in that respect have reference to what it was in 1951 and '52? Was he then taking any interest in and doing [71] any work in the way of repair?

The Witness: No; not at that time.

The Court: All right; that is all.

That was the basis of my ruling, because he was talking about something now, whereas the years involved are '51 and '52.

Mr. Andersen: Yes, your Honor.

Q. (By Mr. Andersen): Mr. Spiesman, in your experience with coin-operated amusement and gaming devices, is the income chiefly from the machine, the asset itself, or is it from the services of taking care of the machine? Which is the predominant

(Testimony of Mathew J. Spiesman, Jr.)

part? What I am trying to do is to show the relationship between capital and services, the income from the machines.

A. The machine is the, is a source of income.

Q. It is. And then, of course, you testified that you were well paid for the amount of service that you had given.

Mr. Spiesman, do you have any other—let me ask you this, are you employed by the Gem State Club?

A. Yes.

Q. How much of a salary did you draw there in 1951? A. Six hundred dollars a month.

Q. '51?

A. I believe it was \$600 a month, yes. I could check with Mr. Esmay, but I believe it was.

Q. Your return shows six thousand a year. For '51 [72] I am talking about.

A. That is \$500 a month, then. I am not sure.

Q. How much time, how much of your time in the day did you use as an employee of the Gem State Club, you as manager of that club?

A. I put in probably six hours a day.

Q. In 1952, do you recall how much salary you took out?

A. I think it was \$6,000. I wouldn't say. I am not sure.

Q. Your return shows 75 hundred.

A. That could be.

Q. During 1952, would the time you spent taking care of the business of the club be six hours, as you spent before?

(Testimony of Mathew J. Spiesman, Jr.)

A. About six, about seven hours a day, about six or seven hours a day. I worked for the bartenders on their two weeks' vacation, and when one of them was sick I worked, so I would say seven hours a day would be the average. And I took care of the buying of the stock, whatever it took to run the business.

Q. That is the Gem State Club? A. Yes.

Q. Mr. Spiesman, going back to the gifts made by your father to the children, they were bona fide gifts, and there were no strings on it, absolute ownership has been conveyed to your children? [73]

A. That is right.

Q. Mr. Spiesman, have you had any bookkeeping experience? A. None whatever.

Q. Who does your accounting work for you?

A. Kenneth Esmay.

Q. How often does he take care of your accounts?

A. He comes in about every three months and makes the Social Security returns and all of, catches them all up.

Q. Brings the records up about every three months? A. Yes.

Q. The coin-operated gaming devices are now illegal in the state of Idaho?

A. That is right.

Mr. Andersen: Will you mark this, please?

The Clerk: Petitioner's Exhibit 15, so marked.

Q. (By Mr. Andersen): Mr. Spiesman, I hand

(Testimony of Mathew J. Spiesman, Jr.)

you a letter here, Exhibit No. 15, and ask you what that is, or what the contents of that letter are?

A. Is this a letter that I wrote——

Q. It is a copy of the letter that you wrote.

A. This is a copy of a letter I wrote to Calvin Wright, Collector of Internal Revenue in Boise.

Q. You were, in substance, asking for an examination? [74]

A. That is right.

The Court: What is the date of the letter?

Mr. Andersen: April 10, 1953.

A. It's not an examination of my own books, but of the partnership of Spiesman & Resor.

Mr. Andersen: I offer in evidence Petitioner's 15. The original was sent to the Director of Internal Revenue.

Mr. Basye: I object on the grounds of immateriality, and no attempt has been made to introduce the original letter, nobody asked us for it. The immateriality of this being that it goes to the firm of Spiesman & Resor.

The Court: What is the purpose of it? What is the materiality of it?

Mr. Andersen: I was going to bring in evidence that the taxpayer had asked for an examination of one phase, and then it went through quite a little bit on how——

The Court: What difference does that make, how they got started in examining?

Mr. Andersen: It is what happened during the examination, was all, one point I wanted to bring out.

(Testimony of Mathew J. Spiesman, Jr.)

The Court: I will let it in.

Just a moment. There is another objection, which is more substantial, and that is the failure to produce the original document.

Mr. Basye: I won't rely on that, your Honor. My [75] objection is as to materiality.

The Court: I don't think it's well to rely upon the other, but if you insist upon it, I will have to rule.

Mr. Andersen: I will withdraw it, then.

The Court: He is not insisting upon the original. Do you want to stand by your offer or do you want to withdraw it?

Mr. Andersen: I will withdraw it, as long as there is objection to it.

Do you want to scratch it out?

The Court: No. Don't scratch it out. We have numbers here that we are keeping track of.

(Petitioner's Exhibit No. 15 was withdrawn.)

Q. (By Mr. Andersen): Mr. Spiesman, they have added, as addition to the——

The Court: Mr. Andersen, let me suggest to you—and this is in the friendliest way I know how—that when you are asking a question and you are speaking about “the thing” or “it,” it doesn't mean very much in this record when you later come to read it. If you have reference to specific parties, why don't you refer to them? Get away from that “they.”

Q. (By Mr. Andersen): The Commissioner, in

(Testimony of Mathew J. Spiesman, Jr.)

his deficiency notice, proposes [76] to assess against you a penalty for underestimating, that is, both for the year of 1951 and for the year of 1952. I ask you if you had any knowledge of the law pertaining to the penalty for underestimating?

A. No; I had not.

Q. There was no intent on your part, then, to violate the law or evade taxation? A. No.

Q. Who did you rely on to keep you posted on your tax affairs? A. Mr. Esmay.

Q. Had he ever called your attention to the fact that you were underestimating your tax?

A. No. He hadn't brought it up.

Q. Most of the amount is from the addition to the tax, I mean from the audit, is that right?

A. Yes.

Q. Most of the penalty is as a result of the audit?

A. Yes.

The Court: I understand from both parties that this penalty question depends upon whether or not there is a deficiency found.

Mr. Basye: Yes; except for the amount of the deficiency or the portion of the deficiency that has already been conceded in the issue. [77]

The Court: If there is a deficiency found, then there would be a sufficient amount to impose a penalty?

Mr. Basye: I believe not, as far as the——

The Court: You can brief this and call it to my attention now, but I am trying to get in mind——

(Testimony of Mathew J. Spiesman, Jr.)

Mr. Basye: I believe it would be dependent upon the main issue.

The Court: Mostly dependent upon the main issue?

Mr. Basye: The penalty is mostly dependent upon the main issue, yes. If we had that additional income, the penalty would be applicable just on the amount that has been agreed to so far.

The Court: That is your position, too, Mr. Andersen? I gathered that from your last remark to the witness. Is that substantially correct?

Mr. Andersen: That is right.

The Court: All right. I just want to know what I am confronted with here.

Mr. Andersen: No further questions.

The Court: You may cross-examine, Mr. Basye.

Cross-Examination

By Mr. Basye:

Q. Mr. Spiesman, the accountings that you made with respect to your guardianship of your minor children, that were later submitted to the Probate Court in Benewah County, when [78] did you make those accountings?

A. I made those accountings after the agent came in and told me that there was no, there had been no accountings made. Up to that time I didn't know that we had to make an accounting every year.

Q. In other words, they weren't filed with the court until some time after 1953 or during 1953?

(Testimony of Mathew J. Spiesman, Jr.)

A. They were filed in 1953. My attorney didn't advise me at the time of the guardianship that I had to make an accounting.

Q. Who was your attorney at that time?

A. Buell; Buell is the fellow who drew up the guardianship papers.

Q. Did you ever file any inventory of the assets of any of your wards during the period 1947 to 1953?

A. I don't believe I did, no.

Q. Mr. Spiesman, I believe it is Petitioner's Exhibit 9, which is the partnership agreement of Spiesman & Spiesman, the one between you and your father, which lists on it certain equipment which it recites in the instrument as being owned and in your possession. Do you recall what equipment you had owned and in your possession when you formed the partnership with your father?

A. Do you mean the equipment that I had when we formed the first, Spiesman & Spiesman? [79]

Q. Yes, sir.

A. I think there were 12 Club Bell machines.

Q. What is a Club Bell machine?

A. Twelve Club Bell slot machines.

Q. A regular, ordinary Las Vegas-type slot machine?

A. They were legal.

Q. You put the money in them and you pulled them?

A. They were legal in the State of Idaho.

The Court: He is not asking you whether they are legal. Don't argue. Just answer the questions.

The Witness: Yes, your Honor.

(Testimony of Mathew J. Spiesman, Jr.)

Q. (By Mr. Basye): Was there any other equipment you owned yourself when you went into the first partnership other than the 12 Club Bell machines, as you recall?

A. There were three phonographs.

Q. Did you also have 18 stand slot machines?

A. Yes.

Q. When did you acquire those slot machines?

A. Purchased them.

Q. What was the date you purchased them?

A. I don't remember. I had some of those a long time.

Q. Would it refresh your——

The Court: Before you get away from it, you call them "Club Bell machines," and you may know what it is, I may [80] also, but this record doesn't.

Mr. Basye: Yes, sir.

The Court: Is that a gambling device, what you call the "Club Bell" machine? And the other type, you called them "stand"?

The Witness: Eighteen stand slot machines.

The Court: Were those gambling devices also?

The Witness: Yes, sir.

The Court: They were coin-operated gambling machines?

The Witness: Yes, sir.

The Court: What we call "one-armed bandits"?

The Witness: Yes.

Q. (By Mr. Basye): In other words, all the equipment you owned at this time were ordinary slot machines, other than the phonographs, were

(Testimony of Mathew J. Spiesman, Jr.)

machines in which you put money, pulled a handle, and you may or may not get money in return?

A. Yes, sir.

Q. You said you acquired these machines some time in the past. Would it refresh your recollection if I showed you your depreciation schedule which you submitted with your income tax return? Would it help you if I showed you that?

A. It may help me, yes. I had them quite awhile.

Q. Would it also help you if I showed you the partnership return of Spiesman & Spiesman, attached to which is a [81] depreciation schedule of the assets owned by Spiesman & Spiesman for the year 1952? Would that refresh your recollection, serve to refresh your recollection, of when you acquired these machines?

A. Yes.

Q. Are they the same machines you had in the first partnership?

A. Yes.

Mr. Anderson: Which return do you have there, Spiesman & Sons or Spiesman & Spiesman?

Mr. Basye: We are referring to Joint Exhibit 6-F, please.

Mr. Andersen: Your Honor, he is going back to prior to 1950, which I have no objection to; he is talking about his individual return, but he is now coming up with a depreciation schedule which starts on December 31.

The Court: He is asking him, showing him a document, which he asked would it refresh his recollection as to when he obtained those machines. Now, it wouldn't make much difference whether it was,

(Testimony of Mathew J. Spiesman, Jr.)

when the document was filed or what year it was filed, if it refreshes his recollection.

Mr. Andersen: He was talking back prior to the Spiesman & Spiesman partnership, as I understood. Perhaps I misunderstood him. And he is bringing in the Spiesman & Sons——

The Court: Do I understand you are making some kind [82] of an objection?

Mr. Andersen: Yes.

The Court: What is it you are objecting to?

Mr. Andersen: I am objecting to him bringing in the depreciation schedule as of December 31, 1951, when he is talking of a time prior to February, 1950. If he will bring his time up, I would have no objection then.

The Court: I will overrule the objection.

Mr. Andersen: Very well.

Q. (By Mr. Basye): Would you look at your original of the 1952 Spiesman & Son partnership return?

The Court: Is that in evidence?

Mr. Basye: A photostatic copy of what has been admitted as 6-F.

The Court: You are showing the witness a document of what has already been introduced in evidence as 6-F?

Mr. Basye: Right, your Honor.

Q. (By Mr. Basye): And I ask you to look at the depreciation schedule affixed thereto.

A. This is as of the close of business of 1952.

Q. I didn't ask you that. I just said look at it a

(Testimony of Mathew J. Spiesman, Jr.)

moment. After you look at it, does that refresh your recollection as to when you acquired the slot machines we have been [83] talking about, after you look at that document?

The Court: Off the record for a moment, please.

(Discussion off the record.)

The Court: On the record.

Q. (By Mr. Basye): You have seen the document. Do you recall now when you first acquired the slot machines?

A. I don't remember when I bought them, but I must have had them on hand there.

Q. Well, did you have them on hand prior to 1947?

A. I may have had some of them. They would be pretty old by then.

The Court: Does the exhibit show how many years of depreciation have been taken?

Mr. Basye: Yes; the exhibit shows the dates that he acquired certain ones of the machines.

The Court: Very well.

Q. (By Mr. Basye): These machines you owned, had you operated those machines before you started the partnership, Spiesman and Spiesman, with your father? A. Yes.

Q. You operated those machines as yours, they were your machines? A. Yes. [84]

Q. Your father never passed any money to you to buy those machines?

A. My father advanced me the money when I

(Testimony of Mathew J. Spiesman, Jr.)

opened the Gem State Club, he loaned me the money, or advanced it. I never paid him back.

Q. Was that money used to buy these machines?

A. Yes; that was 1944.

Q. In other words, you bought these slot machines in 1944?

A. I don't say I bought those slot machines. I bought some slot machines in 1944.

Q. Was any of it purchased with your own money?

A. Well, by the time I had the Gem State Club equipped I was a little short.

Q. Mr. Spiesman, let's ask about this Gem State Club. In other words, this is a building, is that right, the Gem State Club is located in a building?

A. It's in a building, yes.

Q. A building owned by the club? A. No.

Q. What is the business of the Gem State Club?

A. The Gem State Club is a corporation.

Q. What is its business? A. It's a bar.

Q. In this club were machines, is that right, slot machines? [85] A. That is right.

Q. And some of these slot machines were your slot machines? A. All of them were.

Q. They didn't belong to the club, they belonged to you? A. That is right.

Q. And you were president of the club, is that right? A. That is right.

Q. Were these machines licensed after the year 1947 in your name?

(Testimony of Mathew J. Spiesman, Jr.)

A. They were always licensed in the name of the Gem State Club.

Q. Were they ever licensed in the name of your father? A. No.

Q. And none of them are licensed in your name, Mr. Spiesman? A. Not that I know of.

Q. They are all licensed in the name of the club?

A. The agreement between me and the Gem State Club, of which you have a copy, agrees that the Gem State Club is to pay for the license.

Q. Now, let's go into that, Mr. Spiesman. I didn't get your last remark about that I had a copy of it.

A. Mr. Straub made a copy of the agreement.

Q. There was an agreement, then, between Gem State [86] Club and yourself? A. Yes.

Q. This was a written agreement?

A. It's in the—I didn't hear your question.

Q. Was that a written agreement?

A. Yes.

Q. And what was the nature of the agreement?

A. The agreement was that I owned the machines, maintained the machines, to maintain the machines, and that I was to receive 20 per cent of the receipts.

Q. You were to receive, whatever the machine had left in it after the payouts, at various times you opened up the machines and made collections out of them, you were to get 20 per cent of it?

A. That is right.

Q. And who was to get the rest of the balance?

(Testimony of Mathew J. Spiesman, Jr.)

A. The rest of it was to go to the Gem State Club.

Q. And this covers the period of time, now, from when, that this agreement was in operation?

A. I didn't hear you.

Q. What period of time was this agreement in effect?

A. This agreement was in effect—I don't remember the exact date. I think——

Q. Was it in effect during 1951 and 1952?

A. Yes. [87]

Q. And the income that is shown on the partnership returns of Spiesman & Sons for the years 1951 and 1952 actually represents receipts that you got from the Gem State Club? A. That is right.

Q. And these receipts were from the operation of the machines, is that right?

A. And some, there was some phonograph income, not very much, though.

Q. I see. You also had phonographs that you were more or less leasing to the club, is that right?

A. No; they were out on location in different places.

Q. But in the club there were just slot machines, is that right?

A. There was a phonograph in there, too, but the slot machines was the main source of income.

Q. At no time during——

The Court: Does that refer to the year 1951? Does that testimony refer to the year 1951?

Mr. Basye: 1951 and 1952, I believe.

(Testimony of Mathew J. Spiesman, Jr.)

The Court: 1952, is that correct?

The Witness: Yes.

Q. (By Mr. Basye): Prior to 1951 and 1952 you also had that agreement in effect, is that right?

A. Yes. [88]

Q. Say, 1950, was that agreement in effect, as far as you know? A. Yes.

Q. And you were receiving this division or 20 per cent from the Gem State Club of what the machines were bringing in? A. Yes.

Q. And that was accounted for in your partnership return of Spiesman & Spiesman for the year 1950? A. Yes.

Q. For that portion of 1950 that you were in operation? A. Yes.

Q. Was the partnership in operation before the year 1950? A. Yes.

Q. How did you account for receipts that you got under that same agreement before that time, say, '49, did you take that up in your income tax return individually?

A. The returns have been filed every year, yes.

Q. But as far as those machines were concerned, you have never had any other partnership that held those machines at all?

A. No; I owned it before this Spiesman & Spiesman.

The Court: You say you owned them. You individually owned them?

The Witness: Individually, that is right. [89]

(Testimony of Mathew J. Spiesman, Jr.)

The Court: That was before Spiesman & Spiesman. When was that partnership formed?

The Witness: In 1950.

The Court: So they were always your machines prior to these partnership formations, the formation of your partnerships?

The Witness: Yes.

The Court: Prior to that your father didn't own any of them?

The Witness: No.

The Court: Go ahead. I will have a question or two on that later, but I don't want to interrupt your examination.

Q. (By Mr. Basye): When you formed or entered into a partnership agreement with your father for the operation of a partnership, Spiesman & Spiesman, were you given any money for the machines that you apparently put into that partnership—did your father put any money in them, in other words?

A. Yes; he put in half of the book value.

Q. What was that money used for, to purchase new machines?

A. To purchase one-half of them.

Q. As far as you know, though, your father never got a license to operate a machine in Idaho? [90]

Mr. Andersen: I object to that testimony. Merely because he is not an interested party.

The Court: He didn't have a license.

Mr. Basye: I will withdraw the question.

Q. (By Mr. Basye): With respect to the equip-

(Testimony of Mathew J. Spiesman, Jr.)

ment we are talking about here, which are slot machines, you told me how you actually accepted the gift of an undivided interest in those machines, you said you accepted the gift of an undivided interest in those machines from your father on behalf of your wards, which were your children. How did you accept it? Did he come to you one day and tell you that he was giving his interest in it to the children? Is that what happened?

A. When we drew up the Spiesman & Sons document.

Q. Partnership? A. Yes.

Q. Although there is nothing in the Spiesman & Sons partnership agreement that talks anything about the children making capital contribution of a hundred dollars for their interest, is there?

A. I believe there is.

Mr. Basye: The instrument speaks for itself. I won't pursue that.

Mr. Andersen: He has already testified to that anyway. [91]

Q. (By Mr. Basye): Mr. Spiesman, you testified that you recall correcting Exhibit 10, which is Petitioner's Exhibit 10, dealing with the partnership agreement of Spiesman & Sons. Do you remember when you corrected that?

A. Is this the——

Mr. Andersen: Your Honor, he testified that it was about, right about the time of the examination.

The Court: This is cross-examination, unless you have an objection.

(Testimony of Mathew J. Spiesman, Jr.)

A. This is the partnership of Spiesman & Sons, this is the document that drew it up?

Q. (By Mr. Basye): That is right.

A. Yes; we corrected that after Straub said I owned the machines alone.

Q. Do you recall what date that might have been?

A. It was 1953, but I don't know what date it was.

Q. Was it about the time you started filing your inventories and accountings with the probate court?

A. No. It was before that.

Q. It was before that? A. Yes.

Q. You testified that you came to Boise after reading the article in the magazine and discussing it with your father [92] for the purpose of establishing a family partnership, and you testified you visited a lawyer's office. Can you tell me his name again? A. Warnett & Crowley.

Q. And you talked with him and he told you it was all right to form a partnership?

A. He told me he would have to look it up and advised me to see the Tax Department.

Q. Do you recall advising him of what the partnership business constituted?

A. Yes. I told him that it was the operation of machines and phonographs.

Q. You also testified, Mr. Spiesman, about the sum that you were drawing out of the partnership of Spiesman & Sons. I ask you, what were your

(Testimony of Mathew J. Spiesman, Jr.)

duties as manager of that partnership for which you were being paid? What were your duties?

A. I was to operate the machines and keep them in repair.

Q. By "operate," you mean just maintain them, see that they weren't broken and got fixed when they needed it, when necessary?

A. That is right.

Q. Did it also involve opening up the machines and taking out the money?

A. Yes, sir, accounting. [93]

Q. Did anyone ever have any access to those machines other than yourself, I mean a key to the machines, to get the money out? A. Yes.

Q. Who did?

A. When I would be out of town I would leave the keys there for my father to take care of.

Q. And anybody in the Gem State Club, who worked for them, other than yourself or your father?

A. They could have used the keys, and I have no doubt some of them did.

Q. What were your duties with respect to the Gem State Club? You testified that you were paid a salary for your services in 1951 and '52.

A. To operate the bar, buy the stock, hire and fire the bartenders and try to keep them steady, keep steady men there.

Q. In other words, you sort of managed the club?

A. Yes.

Q. You were the boss? A. Manager.

(Testimony of Mathew J. Spiesman, Jr.)

Q. You were president of the corporation?

A. Yes.

Q. I have one more question, Mr. Spiesman, and that is getting back to the gift of the partnership interest. How was that partnership interest transferred to you as guardian [94] for the wards?

The Court: Which partnership are you speaking of?

Mr. Basye: Of Spiesman & Sons.

A. Spiesman & Sons? Well, my father gave the children each the amount that he gave them and it was in the agreement that they were to receive the income divided that way, in other words, 1/9th.

Q. (By Mr. Basye): I see. What it was was an assignment of interest of income?

A. It was an assignment of his 50 per cent interest in the machines and phonographs.

Mr. Basye: I have no further questions, your Honor.

The Court: Anything on redirect?

Redirect Examination

By Mr. Andersen:

Q. Mr. Spiesman, Section 1518.25 of the Idaho Code requires the filing of an inventory of the estate. Now, when you, in 1953, made this inventory you did it at the suggestion of the probate judge, did you?

A. That is right.

Q. And in compliance with the law?

A. That is right.

(Testimony of Mathew J. Spiesman, Jr.)

Q. In other words, you were doing only what you were bound to do?

A. That is right. [95]

Q. Mr. Spiesman, the counsel for the Commissioner of Internal Revenue brought up licenses. In all the time that you have been in the business of operating and maintaining coin-operated gaming devices, what is the policy that you know of, what is the general policy with regard to the locations of where the machines are placed? If someone owns the machine, what does the location do?

A. The location buys the——

Mr. Basye (Interrupting): That calls for an opinion that I don't think he is qualified to give.

Mr. Andersen: Well, let's let him answer on his own machines, then.

The Court: Are you referring to his own policy, as to where he places the machines?

Mr. Basye: I withdraw the objection, if——

Mr. Andersen: I asked as to a general policy.

The Court: I will sustain the objection, if that is what you are asking.

Q. (By Mr. Andersen): Was it the policy on the machines that you had out, Mr. Spiesman, whether they were phonographs or coin-operated amusement or gaming devices, whether or not the location paid for the federal tax stamps and the state licenses, and were they in their name or was it in the name of the partnership or [96] yourself?

A. It was in the name of the location.

Q. And it always was? A. Yes.

(Testimony of Mathew J. Spiesman, Jr.)

Q. And that is what was usually required, too, wasn't it, by the Internal Revenue office?

A. Yes.

Q. Mr. Spiesman, there was testimony about your agreement when you formed the partnership of Spiesman & Spiesman. There was a new agreement entered into wherein your father and yourself—I will ask you if it was oral—wherein your father and yourself then contracted with the Gem State Club or any other location whereby you furnished the machines for, as in the case of the Gem State Club you took 20 per cent, but others you took 50, and I ask you if that wasn't a new contract between the partnership then, consisting of yourself and your father and the Gem State Club or the new location?

A. We didn't have any agreement with the Gem State Club. We carried on the old one.

Q. Did you assign it, or, in other words, where did your father get the rights?

A. We just signed it over.

Q. When you had the partnership formed of Spiesman & Sons, you from time to time put machines in locations and you also had the Gem State Club. Was this an agreement then [97] between the new partnership and the club?

A. No. We carried it right on through.

Q. But it was an assignment, was it?

A. Yes.

The Court: What do you mean, it was an as-

(Testimony of Mathew J. Spiesman, Jr.)

signment? Was there some written assignment of an agreement?

Mr. Andersen: No; there wasn't, that I know of.

The Court: Then it was just something that was done, is that it?

Mr. Andersen: Yes.

The Court: Is that it?

The Witness: It was agreed upon to continue to carry on the same——

The Court: How do you mean, agreed upon? Did you discuss the matter and say, "This is what we will do"?

The Witness: Yes.

The Court: You and your father?

The Witness: My father and I and the directors of the Gem State Club.

The Court: You say that is a corporation? Who owns the stock of the Gem State Club?

Mr. Anderson: It is a non-profit organization, your Honor. Could I explain one thing to you?

The Court: No. I want testimony here, or testimony of the witness, or documents, not testimony of counsel. If you [98] think it's important, get it in. If you don't, leave it out.

Q. (By Mr. Andersen): Mr. Spiesman, you did not consider that you were the owner of the machines and then therefore owner of the income from the machines entirely after you formed your partnership of Spiesman & Spiesman and then subsequently the partnership of Spiesman & Son?

A. No.

(Testimony of Mathew J. Spiesman, Jr.)

Mr. Andersen: That is all.

The Court: Anything further on cross-examination?

Recross-Examination

By Mr. Basye:

Q. You testified, Mr. Spiesman, that these licenses were issued usually in the name of the Gem State Club. Is that right? Do I understand that to be true? A. That is right.

Q. Who paid the license fees?

A. The Gem State Club.

Q. Did you on the 1952 partnership income tax return, for Spiesman & Sons, take deduction for license fees? Do you recall that you did?

A. I don't recall that, no. I don't believe we did, not on the Gem State Club, no, I don't believe there was any deduction for licenses.

The Court: Were there any other, were there any [99] deductions taken on the income tax returns referred to as to machines, for licenses for machines located any place else than the Gem State Club?

The Witness: No; we had only phonographs out, and there wasn't any in other locations.

Q. (By Mr. Basye): Another question, Mr. Spiesman: You testified on direct examination concerning your opinion as to what produced income from machines, whether it was capital in the form of the machines or whether it was in services, and you gave an answer that it was capital. Is that true?

A. That is right.

(Testimony of Mathew J. Spiesman, Jr.)

Q. Is it also your opinion that it would be very pertinent as to the amount of income you might derive from a machine, depending upon where the location of that machine was? A. Well, yes.

Q. That would be a factor, would it not?

A. That is a factor, yes.

Q. Did you consider that the fact that these machines were in the Gem State Club, that was the best place that you could place them, and you put them there only because you had an agreement between yourself as president of the club and yourself as owner of the machines? A. Yes.

Mr. Basye: No further questions. [100]

Redirect Examination

By Mr. Andersen:

Q. The agreement between the club and yourself was prior to the formation of the partnership?

A. Yes.

Q. Then, the agreements with the club and—and that would be between the partnership of Spiesman & Spiesman, and then when they formed the partnership for Spiesman & Sons, the agreement would be between the club, as to the leasing of the machines, dividing of the profits? A. Yes.

Mr. Andersen: I have nothing further.

The Court: I wish you would clear something up for me, Mr. Spiesman. You have been referring to the ownership of these machines at the time they were put into the partnership of Spiesman & Spies-

(Testimony of Mathew J. Spiesman, Jr.)

man, that is, the partnership between you and your father.

The Witness: Yes.

The Court: And the agreement which has been offered in evidence here as Exhibit 9 states that you then were in possession of and owned those machines, they were wholly yours, your father owned no interest in them at all. Is that correct?

The Witness: That is correct.

The Court: And you put the machines into the partnership? [101]

The Witness: Yes.

The Court: That was your contribution to that partnership?

The Witness: My father gave me 18——

The Court: I asked you, was that your contribution to that partnership?

The Witness: Yes.

The Court: Your father, according to the exhibit, agreed to pay a sum equal to one-half of the value of the assets. They were the assets, is that correct?

The Witness: The machines were the assets.

The Court: And he was to pay one-half as much, now, as your machines and the amount he put in went?

The Witness: He gave me a check for half of the book value of the machines.

The Court: All right.

The Witness: That was half of the assets.

The Court: Then he bought them from you be-

(Testimony of Mathew J. Spiesman, Jr.)

fore they were put in, is that correct? Did you keep that money yourself?

The Witness: Yes.

The Court: And the money that he paid then didn't go into the——

The Witness: I put that in my personal account; [102] that was my money.

The Court: You kept the money?

The Witness: Yes.

The Court: In other words, he bought one-half of your interest in the machines and then the machines went into the company?

The Witness: That is right, he bought right in with me.

The Court: That is the impression I got from first reading the instrument, it looked thereafter as if he owned one-third and you owned two-thirds.

The Witness: No.

The Court: That is sufficient on that.

This, I believe, may have been covered, but if it has it won't do any harm to go over it again. I believe these accounts that you filed with the probate court, you filed with them an account of money received on behalf of your wards, your children?

The Witness: Yes.

The Court: But you did not file, as I understand your testimony, any such accounts until the year 1953?

The Witness: That is right. I didn't know I——

The Court: That is, after the agents of the In-

(Testimony of Mathew J. Spiesman, Jr.)

ternal Revenue Service had begun their investigation of your income tax transaction? [103]

The Witness: Then, Your Honor, when I got——

The Court: Is that correct?

The Witness: That is correct. And then I got legal advice.

The Court: All right. Now I am trying to get the time of this. Had you at any time prior to that time filed any fiduciary returns with the Internal Revenue Service or Internal Revenue Bureau, as it may have then been known, as guardian of your five children?

The Witness: No. I had cashed dividend checks and put the money away for them.

The Court: What did you do with the money that you received from these dividend checks? That is on the stock, is that right?

The Witness: That is right. I bought war bonds for the children.

The Court: In their names?

The Witness: Yes.

The Court: You immediately used the income or the dividends received on the——

The Witness: That is right.

The Court: On the mining company stocks?

The Witness: And bought bonds.

The Court: And bought bonds in their names?

The Witness: Yes, sir. [104]

The Court: Their names alone or——

The Witness: Just their names alone.

(Testimony of Mathew J. Spiesman, Jr.)

The Court: You are not put on there as co-owner or beneficiary or anything of the sort?

The Witness: I think we put it on there that I was the parent or guardian, yes.

The Court: Were you?

The Witness: I am not clear on——

The Court: On any of them did you designate yourself or anybody else as co-owner of those bonds?

The Witness: No, those bonds belong to the children.

The Court: Did you put on there anything with respect to who was beneficiary in the case that the child died?

The Witness: Their mother.

The Court: Their mother?

The Witness: Yes.

The Court: I wish you would give me, if you can, the birthdates of your children. We have been referring to their ages as of certain times and if you will give me the birthdates of each of your children, beginning with the oldest, I think we can figure out the ages as of any particular time.

The Witness: Joe was born in 1940.

The Court: Do you remember the month and day? [105]

The Witness: It is hard for me to—his birthday is this month, 16th, I believe. I have forgotten my wife's anniversary——

The Court: That is the one you call Joe. Is that Michael Joe?

(Testimony of Mathew J. Spiesman, Jr.)

The Witness: Michael Joe.

The Court: Go ahead.

The Witness: Phillip James was born—Phillip is 13.

The Court: He is 13 now?

The Witness: Yes. I furnished Mr. Andersen with, I asked my wife this same question and I gave him the correct dates. If I could get them from him I could——

The Court: If you have some notation, it would help.

The Witness: I can't remember them. This is in my writing. She gave it to me.

The Court: That is all right. You go ahead and read the dates.

The Witness: Joe's is October 21, 1940.

The Court: Phillip James?

The Witness: November 29, 1943.

The Court: Leonard John?

The Witness: February 11, 1945.

Mr. Andersen: We now want Mathew J., III.

The Witness: July 3rd, 1946.

The Court: And Francis Edward—is that [106] right?

The Witness: Yes. September 26, 1950.

The Court: All right. That, I think, will be all right. We don't need to get confused on ages now.

Is there anything further that you gentlemen have?

Mr. Andersen: Your Honor, I would like to clear one thing there. You asked the question was

(Testimony of Mathew J. Spiesman, Jr.)

there any fiduciary returns filed. The guardian filed returns any time any one of the children had over the required amount of income, he filed a return for them. For instance, if the child got over \$600 in dividends, why, of course then he filed a return.

The Court: There was an income tax return filed for each of the children?

Mr. Andersen: That is right.

The Court: Is that correct?

The Witness: I don't know what you mean by "fiduciary returns."

The Court: Go ahead.

The Witness: We file tax returns for these children every year, we did even before this partnership began.

Further Recross-Examination

By Mr. Basye:

Q. You mean for the time that the partnership was organized?

A. No, before. These children have filed tax returns ever since their income went over \$600.

The Court: Is there anything further? [107]

(No response.)

The Court: Stand aside.

(Witness excused.)

The Court: Call your next witness.

Mr. Andersen: We will call Mr. Esmay.

KENNETH ESMAY

was called as a witness on behalf of the petitioner and, having been first duly sworn, testified as follows:

The Clerk: State your name, please.

The Witness: My name is Kenneth Esmay.

The Court: The Court will be in recess for a few minutes.

(Short recess.)

The Court: The Court will be in session.

Direct Examination

By Mr. Andersen:

Q. Where do you live?

A. St. Maries, Idaho.

Q. What is your occupation?

A. Accountant.

Q. How long have you been an accountant?

A. Eighteen years.

Q. Did you prepare the income tax returns for Mr. M. J. Spiesman, Jr., for the years of 1951 and '52?

A. Yes, I did. [108]

Q. How about the partnership of Spiesman & Spiesman for '51?

A. I prepared those.

Q. And Spiesman & Sons for 1951?

A. I prepared that.

Q. And 1952? A. Yes.

Q. Mr. Esmay, did you advise Mr. Spiesman

(Testimony of Kenneth Esmay.)

with regard to a penalty for underestimating for 1951 or '52?

A. I didn't advise him that at the time he possibly was delinquent. In his operation, it is highly flexible and dividends and other incomes are generally hard to predict. We generally took a chance that the estimate would be high enough to cover and any time it wasn't we were in error.

Q. Did you discuss with him this matter?

A. Mr. Spiesman and I.

Q. Did he know that there was a penalty?

A. He knew there was a penalty, but he never was apprised of the condition that he might be short in his estimate. That would be more my error than anyone else's.

Q. Did you know that he was short?

A. Not at the time, no.

Q. And you hadn't advised him?

A. I didn't advise him, no. [109]

Q. And there was no intention, as far as you, to violate the law or evade taxation?

A. No. It was negligence on my part.

Q. Any time anything has ever been called to your attention have you complied? A. Yes.

Mr. Andersen: That is all.

(Testimony of Kenneth Esmay.)

Cross-Examination

By Mr. Basye:

Q. One question, Mr. Esmay. You stated on direct examination that you had prepared the partnership return for Spiesman & Sons for the year 1952. Do you recall whether you had signed that return as preparing it?

A. I have signed every tax return that has been reported on the Spiesmans.

Q. Except that one?

A. No, I signed that one also, I am sure.

Mr. Basye: The document speaks for itself, your Honor. It is in evidence.

The Court: Is it in evidence?

Mr. Basye: The document is in evidence, your Honor.

The Witness: Is it implied that the '52 return wasn't signed by me?

Mr. Basye: The '52 partnership return, [110] yes.

The Witness: It hasn't been signed by me?

Mr. Basye: I would like to make reference to the——

The Court: Do you want to look at the document?

The Witness: I don't know why I didn't sign it. I signed it all the years previous and all since. That may have been an error on my part that it wasn't signed, because I know that I signed it before and since, I didn't realize that one had been omitted. That is my error also.

(Testimony of Kenneth Esmay.)

The Court: Do you want to examine it?

The Witness: No. I will take his word for it.

Q. (By Mr. Basye): As the accountant for Mr. M. J. Spiesman, Jr., during the years of 1951 and '2, do you have any personal knowledge that you can give to the Court as to what Mr. Spiesman might have done with any withdrawals that were credited on the books and accounts of Spiesman & Sons partnership to the withdrawal accounts of these children? Do you know of your own knowledge?

A. You will find that every withdrawal that was ever made from the Spiesman & Sons partnership relative to the money drawn from those accounts that would correctly be stated as belonging to the children, that that money went to three places, we might say. It either went to the Farmers & Merchants Bank at Rockford, Washington, it went to pay on a Sun Life Insurance policy—I take it back, there would be four—[111] it also went to pay their own income taxes, state and federal, and also occasionally a security was purchased for them in the stock exchange through a Merrill, Lynch, Pierce, Fenner & Beane account.

Q. Mr. Esmay, do you know this of your own personal knowledge? Did you draw checks or see checks drawn by Spiesman & Sons partnership payable to the children's account at the bank or what?

A. If money was drawn from the partnership

(Testimony of Kenneth Esmay.)

fund, the partnership's bank account, it was drawn by check.

Q. It was drawn by check?

A. Yes. If money was taken from their personal bank account at the Rockford bank, it was drawn by cash.

Q. I didn't have any question about that.

A. Yes, sir.

Q. I had question about how the money came out of Spiesman & Sons partners.

A. Yes, sir. It was always drawn by check.

Q. But you don't know anything about what deposits Mr. Spiesman might have made, yourself, you of your own personal knowledge?

A. Yes, I do. Everything deposited, every deposit that was ever made, is fully accounted for on the passbooks of the bank at Rockford.

The Court: Were those individual accounts of each [112] child?

The Witness: Yes, each child has his own pass-book.

The Court: In other words, when the money was withdrawn from Spiesman & Sons——

The Witness: Yes.

The Court (Continuing): ——that was done by check?

The Witness: It was done by check.

The Court: And that check, you say, was deposited to the individual account of the child?

The Witness: Of the child. They deposited the check drawn from the Spiesman & Son partner-

(Testimony of Kenneth Esmay.)

ship. That check may be followed through and shown as a deposit to the individual's account at the bank at Rockford, and it will be recorded in the passbook.

The Court: Did you keep a set of books for Spiesman & Sons?

The Witness: Yes, I did.

The Court: You kept those books yourself?

The Witness: I kept a journal.

The Court: How often did you work on those?

The Witness: I worked on it periodically, say, sometimes by the month, sometimes quarterly. I prepared all papers necessary for payroll recordings and also prepared all closings for income tax reporting and also the inventories for the probate court, the annual account of inventory. I have [113] prepared all of those reports.

The Court: From what had you prepared those?

The Witness: From this journal that I kept.

The Court: I understood that you were not in daily contact with them, then?

The Witness: Well——

The Court: With their daily books kept or anything to show what income was being received and what was being disbursed and all that?

The Witness: Your Honor, I would take the bank statement by the month from the Spiesman & Sons activity, and from that I would report all deposits to that account, all withdrawals from that account, business expense and personal withdrawals for the members of the partnership.

(Testimony of Kenneth Esmay.)

The Court: What kind of books did the partnership itself keep? That is what I am interested in.

The Witness: The partnership itself had a set of books like this. Once a week the partnership received its income from the coin-operated machines, and that deposit was made regularly to the bank account at which the Spiesman & Sons banking was done.

The Court: And who did that?

The Witness: Who made the deposits?

The Court: Yes.

The Witness: Mr. Spiesman, Bud, Junior, he made [114] those deposits.

The Court: What you did, then, was to take the bank books——

The Witness: Yes.

The Court (Continuing): ——afterwards and make allocations?

The Witness: I would take the deposit tickets and reconcile it with the bank statement and post my journal from that.

The Court: You say you are an accountant. Are you a certified public accountant?

The Witness: No, I am not. I studied for certified public accountant, but I never did take the examination.

The Court: Anything further?

Q. (By Mr. Basye): You stated that you had done work on the inventory and the accountings, annual accountings, that were subsequently filed by Mr.

(Testimony of Kenneth Esmay.)

Spiesman in the guardianships? A. Yes.

Q. When do you recall that you did that work?

A. I did that work in 1953.

Q. You were never asked by Mr. Spiesman to do anything along that line prior to that time?

A. We were not advised that we had to do that, no.

Mr. Basye: That is all the questions I have. [115]

The Court: I want to ask one more question on this penalty situation.

When you were drawing up or preparing the declarations of estimated income—you prepared those also?

The Witness: Yes.

The Court: I understood you to say that you discussed with Mr. Spiesman, Jr.—

The Witness: Yes.

The Court (Continuing): —what amount should be stated as estimated income?

The Witness: Yes.

The Court: Did you at that time advise him of anything with regard to there being a penalty for underestimation?

The Witness: Yes, he understood that there would be.

The Court: Were these estimated tax returns always filed, the single return, or did you have the subsequent returns that might be filed in June or September, at later dates?

The Witness: Well, these individual returns--

(Testimony of Kenneth Esmay.)

you are referring to the ones for the boys now, or just the personal returns?

The Court: Referring to his own personal returns. This petition in this case is in the case of Mathew J. Spiesman, Jr., and his wife.

The Witness: I had the access, of course, to all [116] records and it was up to my advice what would be the best thing to do, and income was highly flexible in his type of business, we never knew to the full quarter sometimes how good a dividend was going to be in the stock market. Mr. Spiesman has quite a vast holding in the stock market due to his Merrill, Lynch, Pierce, Fenner & Beane account, and also we never knew how good an income we were going to have, take the third quarter, of October, November, December, that was quite lucrative months in the business he was in.

The Court: Did you ever undertake to file a corrected return on or before January 15?

The Witness: Yes. I had filed amended returns, what we called the amendment to an estimate.

The Court: That is right.

The Witness: We had filed those, and then still would miss.

The Court: What about the years '51 and '52? Were they filed then?

The Witness: I would have to go take a look to see.

The Court: Are they in evidence?

(Testimony of Kenneth Esnay.)

Mr. Basye: They might be attached to the returns themselves.

The Court: Either they are or they are not in evidence, and if there were any amended estimates filed they are part of the exhibits that have already been put in evidence, [117] is that right?

Mr. Andersen: I would have to look, your Honor. I would like to look at Exhibits 1 and 2, I believe.

Mr. Basye: Exhibits 1-A and 2-B. They are attached to the original, at least, your Honor.

The Court: Are you talking for the record or just conferring together?

Mr. Basye: Off the record.

Your Honor, I do have in my possession what purports to be the original income tax return from which the photostatic copies which have been submitted in evidence were prepared, and for the year 1951, attached thereto, shows that on March 15, 1951—this is all off the record——

The Court: It's not off the record, it's on the record. You are addressing me now.

Mr. Basye: I am sorry, your Honor. I have in my possession such a document which shows received in the District of Idaho, March 15, 1951, was a declaration of estimated tax form, 1040-ES, of Mathew and Mary Spiesman, whereby the 1950 income tax was shown and an estimated tax for 1951 was shown, the estimated tax for the year 1951 was in the amount of four thousand dollars,

(Testimony of Kenneth Esmay.)

amount paid with the original estimate was one thousand dollars.

Subsequently, on January 15, 1952, there was received in the office of the Collector of Internal Revenue, District [118] of Idaho, an amended declaration of estimated tax for Mathew and Mary Spiesman, showing an estimated income tax for the year 1951 in the amount of \$9,500, of which the amount of \$6,500 was still owing. Apparently they submitted that at the time they filed their estimated return, on the original return, which is in evidence as Exhibit 1-A. It shows they took credit for having paid on declarations of estimated tax for 1951, the amount of \$9,500.

The Court: And would that be the situation that would apply with respect to '52, would there be amendments there?

Mr. Basye: The same situation would hold true in '52, they did file amended returns, an original and amended declaration of estimated tax, and on their final return, which is in evidence as Exhibit 2-B, they claim \$6,500 as having been paid by declaration of estimated tax for the year.

The Court: All right. It may not be too important, in view of the fact that perhaps this whole question of penalty may depend upon whether or not a deficiency is determined.

Mr. Basye: I still think that is the case, although we have run into certain amounts.

The Court: All right, if we run into something different, we have the record for it.

Is there anything further?

Mr. Basye: I have no further cross-examination of [119] the witness.

The Court: All right, you may stand aside, Mr. Esmay.

(Witness excused.)

Mr. Andersen: That is all I have, Your Honor.

The Court: Petitioner rests?

Mr. Andersen: Yes.

The Court: Respondent?

Mr. Basye: Will you mark for identification Respondent's Exhibit H.

The Clerk: Respondent's Exhibit H, so marked.

(Respondent's Exhibit H was marked for identification.)

Mr. Basye: This purports to be, on its face, a certificate, with the seal of the Judge and the ex officio Clerk of the Probate Court of Benewah County, which purports to be a complete record of all documents and orders issued in the Probate proceedings involving the guardianship of Michael Joseph Spiesman; Leonard John Spiesman; Mathew J. Spiesman, III; and Phillip James Spiesman up to the time of October 23, 1953. I offer it in evidence, Your Honor.

The Court: Respondent's Exhibit H is received in evidence.

(Respondent's Exhibit H was received in evidence.)

Mr. Andersen: The probate records only bring

in four of the boys. The fifth one isn't in there. I was wondering—— [120]

Mr. Basye: The reason it isn't there is because there have been no probate proceedings with respect to the time that that record speaks, which is in November of 1953. He hadn't been appointed a guardian of that child at that time.

Mr. Andersen: On what date?

Mr. Basye: I will have to look at the date of the certificate again.

Mr. Andersen: On November, and he was appointed on October 13.

Mr. Basye: Let me look at the record, counsel. It speaks as of October 23, 1953.

Mr. Andersen: The record will show, the exhibit will show, that Mr. Spiesman was appointed guardian of Francis Edward Spiesman on October 13, 1953.

The Court: Well, how does that help us? We have this record in evidence. If there are others that you want, it is up to you to get them.

Go ahead.

Mr. Basye: I will call Mr. Flower.

CLAUDE F. FLOWER

was called as a witness on behalf of the Respondent and, having been first duly sworn, testified as follows:

The Clerk: State your name, please.

The Witness: Claude F. Flower. [121]

(Testimony of Claude F. Flower.)

Direct Examination

By Mr. Basye:

Q. Would you give the Court your home address, Mr. Flower.

A. Rockford, Washington.

Q. What is your occupation, Mr. Flower?

A. Banking.

Q. In that connection, what concern are you now with?

A. Farmers & Merchants Bank of Rockford.

Q. What is your position with that firm?

A. Cashier.

Mr. Basye: Will you mark for identification Respondent's Exhibit I, please.

The Clerk: Respondent's Exhibit I, so marked for identification.

(Respondent's Exhibit I was marked for identification.)

Q. (By Mr. Basye): I hand you Respondent's Exhibit I for identification——

Mr. Andersen: May I see it, please.

Mr. Basye: I would like to have it identified first, please.

Q. (By Mr. Basye): And I ask you if that is an original ledger sheet from the Farmers & Merchants Bank of Rockford, Washington. [122]

A. That is right.

Q. Have you had custody of that original ledger

(Testimony of Claude F. Flower.)

sheet since it left the bank in Rockford, Washington? A. I have.

Q. The original ledger sheet is with respect to what particular bank account at the Farmers & Merchants Bank in Rockford?

A. Spiesman & Sons of St. Maries.

The Court: You will be getting an opportunity to cross-examine. If you want to study it, of course that is another thing. We cannot take time out now to study it.

Mr. Basye: I offer Respondent's Exhibit I in evidence, Your Honor.

The Court: Respondent's Exhibit I is received in evidence.

(Respondent's Exhibit I was received in evidence.)

Mr. Basye: Would you mark for identification Respondent's Exhibit J.

The Clerk: Respondent's Exhibit J, so marked.

Mr. Basye: As I offer these in evidence, I would like at the same time to make a motion to withdraw them and substitute photostatic copies.

The Court: Would you so state at the time you are offering them, so we will know which ones you want to withdraw.

The Clerk: Respondent's Exhibit J, so marked for [123] identification.

(Respondent's Exhibit J was marked for identification.)

(Testimony of Claude F. Flower.)

Q. (By Mr. Basye): I hand you Respondent's Exhibit J for identification and ask you if that likewise is an original ledger sheet from the Farmers & Merchants Bank of Rockford. A. It is.

Q. That you have had in your possession since it left the bank? A. Yes.

Q. Is it an original record of the bank?

A. It is.

Q. What does it purport to be?

A. The savings account of Phillip James Spiesman of St. Maries, Idaho.

The Court: Do you have photostats of these?

Mr. Basye: I do not.

The Court: Now?

Mr. Basye: That is why I asked to withdraw them and have them made.

Mr. Andersen: May I ask a question before they are introduced?

The Court: No. He has to offer them, and then if you want an objection or something of the sort, why, we will consider it. [124]

Mr. Basye: I offer in evidence, Your Honor, Respondent's Exhibit J.

Mr. Andersen: I don't want to raise an objection, but I want to ask a question.

The Court: Has it to do with the identification?

Mr. Andersen: Very much so, Your Honor.

The Court: Very well.

Q. (By Mr. Andersen): Did you bring the de-

(Testimony of Claude F. Flower.)

posit slips here, showing the deposits, what they came from, whether they were Hecla or Bunker Hill & Sullivan, whether they were interest or Hecla dividends, or anything? A. No, I didn't.

Mr. Basye: How would he know that, from the bank?

The Court: Don't get into argument here.

Did you have an objection?

Mr. Andersen: I have an objection to the introduction of that exhibit.

The Court: I overrule the objection.

Mr. Basye: Would you mark for identification Respondent's Exhibit K, please?

The Clerk: Respondent's Exhibit K, so marked for identification.

(Respondent's Exhibit K was marked for identification.) [125]

Q. (By Mr. Basye): I hand you Respondent's Exhibit K and ask you if you can identify that as an original ledger sheet kept in the ordinary course of business by the Farmers & Merchants Bank of Rockford, Washington. A. Yes, I can.

Q. It has been in your possession since it left the bank? A. That is right.

Q. What does it purport to be?

A. This is a record of the savings account of Michael Joe Spiesman of St. Maries, Idaho.

Mr. Andersen: Same exception.

Mr. Basye: I haven't offered it yet, Mr. Andersen.

(Testimony of Claude F. Flower.)

I offer in evidence Respondent's Exhibit K.

The Court: You make the same objection?

Mr. Andersen: Same objection.

The Court: The objection will be overruled, the objection to Respondent's Exhibit K will be overruled, and I don't think I received J, but I will now; both J and K are received in evidence.

(Respondent's Exhibits J and K were received in evidence.)

Mr. Basye: Would you mark for identification Respondent's Exhibit L, please.

(Respondent's Exhibit L was marked for identification.) [126]

The Clerk: Respondent's Exhibit L, so marked for identification.

Q. (By Mr. Basye): I hand you Respondent's Exhibit L for identification and ask you if you can identify that as an original ledger sheet from the Farmers & Merchants Bank of Rockford, Washington. A. I can.

Q. Has that been in your possession since it left the bank? A. Yes, it has.

Q. What does it purport to be?

A. A record of the savings account of Mathew J. Spiesman, III, St. Maries, Idaho.

Mr. Basye: I offer in evidence, Your Honor, Respondent's Exhibit L.

Mr. Andersen: Same objection.

The Court: The objection will be overruled and Respondent's Exhibit L will be received.

(Testimony of Claude F. Flower.)

(Respondent's Exhibit L was received in evidence.)

Mr. Basye: Will you mark this.

The Clerk: Respondent's Exhibit M, so marked.

(Respondent's Exhibit M was marked for identification.) [127]

Q. (By Mr. Basye): I hand you Respondent's Exhibit M for identification and ask you if you can identify that as one of the original ledger sheets from the Farmers & Merchants Bank of Rockford, Washington. A. I can.

Q. And have you been in possession of that since it left the bank? A. Yes.

Q. What does it purport to be?

A. A record of the savings account of Leonard John Spiesman, St. Maries, Idaho.

Mr. Basye: I offer, Your Honor, Respondent's Exhibit M.

The Court: Respondent's Exhibit M is received in evidence, overruling—it may be understood you are making the same objection, and it is overruled.

(Respondent's Exhibit M was received in evidence.)

Mr. Basye: Mark this, please.

The Clerk: Respondent's Exhibit N, so marked for identification.

(Respondent's Exhibit N was marked for identification.)

(Testimony of Claude F. Flower.)

Q. (By Mr. Basye): I hand you Respondent's Exhibit N for identification and ask you if you can identify that as being an original ledger sheet from the Farmers & Merchants Bank of [128] Rockford, Washington. A. I can.

Q. And that, again, has been in your possession since it left the bank? A. It has.

The Court: For whose account is that ledger sheet?

Q. (By Mr. Basye): Could you tell us whose savings account that purports to be a record of?

A. Yes. It's the savings account of Francis E. Spiesman, St. Maries, Idaho.

Mr. Basye: I offer Respondent's Exhibit N, Your Honor.

The Court: Subject to the same objection of the petitioner, which is overruled, Respondent's Exhibit N is received in evidence.

(Respondent's Exhibit N was received in evidence.)

Mr. Basye: At this time I would like leave to move to substitute, to withdraw the exhibits and substitute photostatic copies thereof.

The Court: That has reference to these bank records?

Mr. Basye: To the bank records, which are exhibits I thru M, inclusive.

The Court: Leave is granted to the respondent to withdraw the originals of Respondent's Exhibits I, J, K, L, M, and N and substitute photostatic copies therefor. [129]

(Testimony of Claude F. Flower.)

Q. (By Mr. Basye): Mr. Flower, I hand you Exhibits J, K, L, M, and N, which are all the savings accounts records of the five children, and ask you if you can tell me when each account was first opened.

A. Phillip James Spiesman's account was opened March 17, 1952.

Michael Joe Spiesman's account was opened March 17, 1952.

Francis E. Spiesman's account was opened March 17, 1952.

Mathew J. Spiesman, III's, account was opened March 17, 1952.

And Leonard John Spiesman's account was opened March 17, 1952.

Mr. Basye: I have no further questions, Your Honor.

The Court: Cross-examine, please.

Cross-Examination

By Mr. Andersen:

Q. Mr. Flower, there is shown that on December 31, 1952, in the Michael Joseph Spiesman account there was the amount of \$4,874.83.

A. You wanted the balance as of that date?

Q. That is right.

A. \$4,874.83, yes, sir. [130]

Q. I hand you Respondent's Exhibit M and ask you if the balance in the Rockford Bank is the balance that is shown here, in the accounting of Mr. Leonard John Spiesman, of \$4,673.93.

(Testimony of Claude F. Flower.)

A. What date was that?

Q. December 31, 1952.

A. That is correct.

Q. I hand you Respondent's Exhibit J and ask you if on December 31, 1952, the balance in the Rockford bank of Phillip James Spiesman is \$3,653.21.

A. That is right.

Q. I hand you Respondent's Exhibit L and ask you if on December 31, 1952, Mathew James Spiesman, III's, account in the Rockford bank was \$4,664.01.

A. That is right.

Mr. Andersen: And there is not a certified copy of Francis Spiesman because in '52 Mr. Mathew Spiesman, Jr., hadn't been appointed guardian yet.

Q. (By Mr. Andersen): May I ask you how much was in the bank on December 31, 1956?

A. \$4,663.02.

Q. \$4,663.02? A. That is right.

Mr. Andersen: That is all, Your Honor. [131]

The Court: Is there anything further?

Mr. Basye: I have one question, Mr. Flower.

Redirect Examination

By Mr. Basye:

Q. Do you know, on these savings accounts which have been introduced in evidence, who had the right to withdraw money from the account?

A. So far as I know, M. J. Spiesman, Jr., had that authority.

(Testimony of Claude F. Flower.)

Q. Do you have the signature cards for those accounts?

A. I believe I have those with me.

Q. Could they refresh your recollection if you looked at them, or can you testify of your own independent knowledge that he was the one who could draw money out of those accounts?

A. He was authorized, but whether he was the only one I couldn't say right now.

Q. Could you answer the question if you refreshed your recollection from the signature cards?

A. I think I could.

Q. Do you have such signature cards in your possession? A. Yes, I do.

Q. Would you look at them?

A. I don't have them right here. I have them in my briefcase.

Q. After having refreshed your recollection, can you [132] answer the question whether or not there was anyone other than Mr. Spiesman who had the right to withdraw from those savings accounts?

A. As far as I know, there was not—I was wrong. These apply only to the checking account, only.

Q. They have nothing to do with the signature on the savings accounts that we have asked for, is that right? A. That is correct, yes, sir.

The Court: Do the ledger sheets show, themselves, can you look at those and tell?

The Witness: Those have the names on them only.

(Testimony of Claude F. Flower.)

Mr. Basye: If there is no such evidence in the courtroom, I have no further questions.

The Court: Anything further?

Let me see those ledger sheets, please.

Mr. Andersen: We have no further questions.

The Court: If that is all, you may be excused, sir.

(Witness excused.)

Mr. Basye: Respondent rests, Your Honor.

The Court: Anything further from the petitioner?

Mr. Andersen: I would just like to look one moment to see if I have something to present here.

The Court: We will take a five-minute recess while you examine your notes.

(Short recess.) [133]

The Court: The court will be in session.

Mr. Andersen: May I ask Mr. Flower one more question?

The Court: Do you want to ask him on cross-examination?

Mr. Andersen: I think this will be direct.

The Court: All right.

Will you resume the stand, Mr. Flower.

CLAUDE F. FLOWER

having been previously sworn, was called as a witness on behalf of the petitioner and testified as follows:

Direct Examination

By Mr. Andersen:

Q. I hand you Respondent's Exhibit J and ask you to refer to the first deposit, and I ask you how much that is.

A. The first deposit was for \$1,240.

Mr. Andersen: I offer this as Petitioner's Exhibit 16.

The Clerk: Petitioner's Exhibit No. 16, so marked for identification.

Q. (By Mr. Andersen): I hand you Petitioner's Exhibit No. 16 and ask you what that is.

A. That is a copy of the original deposit slip for Phillip James Spiesman, as of March 17, 1952, totaling \$1,240.

Q. How many items are on there? [134]

A. Five items.

Q. Can you tell me from your records which you brought with you whether or not any of those are dividend checks or not?

A. I might have had one record that would show that.

Q. You didn't bring it along, though?

A. I might have one with me that would show that.

Mr. Andersen: I offer this.

Mr. Basye: I object for the reason it hasn't

(Testimony of Claude F. Flower.)

been purported to be identified. I didn't understand this witness identified that as anything but a copy of a deposit slip.

The Court: Can't you bring out any further identification of it?

Q. (By Mr. Andersen): Is this part of the records that were submitted to Mr. Spiesman as a part of the records for the boy?

The Court: Submitted to Mr. Spiesman?

Mr. Andersen: Submitted by Mr. Spiesman.

A. I didn't get that question quite straight.

Q. (By Mr. Andersen): Is that an official deposit slip?

A. It is not, no. It is a copy of the original.

Q. Who made that up?

A. Our assistant cashier. [135]

Q. And handed to Mr. Spiesman?

A. That is correct.

The Court: Is it a certified copy, certified by the assistant cashier or someone?

Mr. Andersen: It ties in with the very first deposit.

The Court: I understand that, but we are trying to get the identification of it down.

Mr. Andersen: It's a copy.

The Court: Let me ask the witness a question.

How do you know that? From what are you drawing the conclusion for the testimony, the statement, that this is a copy of an original deposit slip? The original deposit slip, I take it, is in your bank?

The Witness: That is correct.

(Testimony of Claude F. Flower.)

The Court: How do you know this to be a copy of that original?

The Witness: At Mr. Spiesman's request for this information, we got out the originals and copied them off.

The Court: Did you copy them off yourself?

The Witness: No, I didn't.

The Court: I understood you to say this was a copy made by somebody else. How do you know that?

The Witness: It was in my presence.

The Court: How do you know that this one is identical [136] to the original? Couldn't somebody have made another and substituted it in its place?

The Witness: Well it's——

The Court: Now, are you positive this is the copy of the original made in your presence?

The Witness: I couldn't swear that it was, since it isn't signed or anything.

The Court: I take it all that you are really testifying to at this time is that Mr. Spiesman requested a copy of a deposit slip, and a copy of the deposit slip was made in your presence?

The Witness: That is correct.

The Court: Now, whether or not this is the copy that was made in your presence, can you testify to that?

The Witness: I am reasonably sure that it is, yes.

The Court: Why do you say "reasonably sure"?

(Testimony of Claude F. Flower.)

The Witness: Well, I think this is the handwriting of our assistant cashier.

The Court: That is in the handwriting—it is not all typed, part of it is in ink, is it?

The Witness: It is all in longhand except the stamp signifying it is a duplicate deposit slip.

The Court: I am not sure whether you said “I think this is” or not. We have to have testimony here and not guess work. Can you testify now as to whether or not that is the [137] handwriting of the assistant cashier?

The Witness: Well, I would say it is, yes.

The Court: Of the cashier who made the copy in your presence?

The Witness: Of the assistant cashier, that is correct.

The Court: Do you want to ask any further questions? I am going to overrule the objection and receive it in evidence.

Mr. Basye: No, Your Honor, I won't ask any questions, nor do I have any objection. If the others are the same, I would stipulate to those, then.

The Court: Have you numbered them?

Mr. Andersen: I have, 1, 2, 3, 4, and a letter, Your Honor.

The Court: Then mark them all, and they will all be admitted at one time.

The Clerk: These are all to be admitted?

The Court: They will. Petitioner's Exhibit 16 is received in evidence. Mark all of them at one time and let's get it over with.

(Testimony of Claude F. Flower.)

The Clerk: Petitioner's Exhibit No. 17, so marked for identification.

The Court: Mark them all at once. Mark the rest of them. There is no need of stringing this thing out.

The Clerk: Petitioner's Exhibit No. 18, so [138] marked.

The Clerk: Petitioner's Exhibit No. 18, so marked for identification.

Mr. Anderson: There will be five altogether.

The Clerk: Petitioner's Exhibit No. 19, so marked for identification.

Petitioner's Exhibit No. 20, so marked for identification.

(Petitioner's Exhibits 16, 17, 18, 19 and 20 were marked for identification.)

The Court: Now hand them all to the witness, all of them at one time.

Mr. Witness, will you look at those exhibits which are marked as Respondent's Exhibits 17, 18, 19 and 20 for identification and state whether or not they are similar records to that, to Petitioner's Exhibit 16.

The Witness: They are.

The Court: You identify them in a similar manner?

The Witness: I do.

The Court: Is there anything else you want?

Mr. Andersen: I offer these in evidence, your Honor.

(Testimony of Claude F. Flower.)

The Court: Petitioner's Exhibits 17, 18, 19 and 20 are received in evidence.

(Petitioner's Exhibits 16, 17, 18, 19 and 20 were received in evidence.)

Q. (By Mr. Andersen): [139] I hand you Petitioner's Exhibit 17, a deposit slip to the account of Francis Spiesman, showing two items totaling \$850, and ask you if that is the first deposit.

A. That is.

Q. One item of \$800 and one of \$50?

A. That is correct.

Q. I hand you Petitioner's Exhibit No. 18, a deposit slip to the account of Michael Joe Spiesman, showing a deposit of \$1,240, showing five items. Would you tell me if that is the first deposit of his.

A. That is right, it is.

Q. I hand you Petitioner's Exhibit No. 18, totaling \$970, having four items, for Mathew J. Spiesman III. Would you tell us if that is the same as the deposit.

A. It is.

Q. I hand you Exhibit No. 20, for Leonard John Spiesman, showing \$1,280 deposit, containing five items. Would you tell me if that coincides with your records.

A. That is correct.

Q. I hand you for identification Exhibit No. 21, bearing your signature. But I don't see any date on there. Would you tell me about when that was written.

A. This was written on Saturday, last Saturday.

Q. Do you know what date that would be?

(Testimony of Claude F. Flower.)

A. The 6th, wouldn't it? [140]

The Court: October 6, if today is the 8th.

The Witness: October 6th, yes.

Q. (By Mr. Andersen): Would you state what that is?

A. This is a record of certain checks that were cleared through the Farmers-Merchants Bank.

Mr. Andersen: I will offer this into evidence.

Mr. Basye: I suggest you ask the witness whether it is his signature or not. I assume it is his name on it.

The Court: Let me see it.

I don't know exactly what you would call it. It is a statement purporting to set forth a record of checks cleared through the Farmers & Merchants bank?

The Witness: On March 17.

The Court: Of what account?

The Witness: Various accounts, the Spiesman accounts.

The Court: Well, you have offered it.

Q. (By Mr. Andersen): That is your signature? A. That is my signature, yes.

The Court: It is received in evidence as Petitioner's Exhibit No. 21.

(Petitioner's Exhibit No. 21 was marked for identification and received in evidence.)

Mr. Andersen: That is all, your Honor.

Mr. Basye: I have no further questions. [141]

(Witness excused.)

The Court: Anything further to be offered by either party?

Mr. Basye: Respondent rests.

The Court: Is there anything further from the petitioner?

Mr. Andersen: Just one moment, your Honor. We don't seem to be able to find the other document, so we will rest.

The Court: If it is going to affect your case, we will take time, if it is material.

Mr. Andersen: It is material. I will call Mr. Mathew J. Spiesman, Jr., again.

The Court: Take the stand, Mr. Spiesman.

MATHEW J. SPIESMAN, JR.

was recalled as a witness on behalf of himself, the petitioner, and, having been previously sworn, was examined and testified further as follows:

Further Direct Examination

By Mr. Andersen:

Q. I hand you this letter and ask you to identify it. A. To identify the circumstances?

Q. No, to identify the letter is all.

A. A letter from the St. Maries bank, First Bank of St. Maries, in regards to Joe's savings account. [142]

The Court: Did I understand you to say that this was the savings account of Joe?

The Witness: The other children's money is in this account.

(Testimony of Mathew J. Spiesman, Jr.)

Mr. Andersen: Michael Joe Spiesman's account.

The Court: This letter, handed to the witness, for identification as I understand it, is a letter from the First Bank of St. Maries regarding the savings account of whom?

The Witness: Michael Joe.

The Court: All right.

Q. (By Mr. Andersen): Who is that letter to?

A. The letter is written to me personally.

Q. And who signed it?

A. G. E. Yenor, president of the bank.

Q. Mr. Spiesman, that is an account in the name of Michael Joe Spiesman with the First Bank of St. Maries? A. Yes.

Q. And it refers to deposits on January 7, '50, January 15, 1951, June 5, 1951, and September 6, 1951. Would you explain those deposits?

The Court: Are you offering this in evidence?

Mr. Andersen: Oh, yes. I forgot to offer it in evidence.

Mr. Basye: I object, your Honor, unless counsel [143] wants to explain to me the purpose of putting it in. He hasn't asked the witness whether he could identify the signature of the person who originated the letter, and I have no chance to identify the originator of the letter. It's mere hearsay, as far as I can see. There has been no showing as to the truth of the matter contained in the letter.

The Court: What have you to say, Mr. Andersen?

Mr. Andersen: My only purpose in offering it

(Testimony of Mathew J. Spiesman, Jr.)

was to show the method that Mr. Spiesman was handling certain dividends that were received from all the boys, having been deposited in one account, you see.

The Court: What is the date of the letter?

Q. (By Mr. Andersen): Who is the letter to?

A. The letter is to me and it is dated October 6, 1956.

The Court: Do you wish to restate your objection again?

Mr. Basye: I object on the ground it is hearsay, your Honor.

The Court: I will have to sustain the objection. We don't have the proper party here apparently to—as far as a letter which he received, yes, but the contents of it, I don't see what good it would do you. You are in a different boat than the one you were in when you had Mr. Flower here. He was the banker. He could testify to the records of his bank. [144]

Mr. Andersen: No further questions.

The Court: I think the record shows that Petitioner's Exhibit No. 22 was offered and the objection to it being received in evidence was sustained.

Mr. Andersen: Yes, sir.

(Petitioner's Exhibit No. 22 was marked for identification and rejected.)

The Court: Is there anything further? Do you wish to cross-examine?

Mr. Basye: No, sir. Respondent again rests.

Mr. Andersen: Petitioner rests.

The Court: Both parties now rest. The case will be taken under submission, with leave to file briefs. Do you wish to file simultaneous seriatim briefs?

Mr. Basye: Seriatim briefs, your Honor.

The Court: How much time do you want for your opening brief? The normal period is 45 days.

Mr. Andersen: I will take the 45.

The Court: Briefs will be filed seriatim, petitioner's opening brief in 45 days, respondent's brief 30 days thereafter and 15 days thereafter for reply. The clerk will read the dates.

The Clerk: Those dates will be November 23rd, the 30-day will be December 24th, and the following 15-day will be January 8th, 1957. [145]

The Court: Do you have the dates, gentlemen?

(No response.)

The Court: That is all for this case.

(Whereupon, at 4:50 p.m., Monday, October 8, 1956, the hearing in the above-entitled matter was closed.)

Filed: October 22, 1956, T.C.U.S. [146]

28 T. C. No. 62

Tax Court of the United States

Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION

Held: The five minor children of the petitioners were not bona fide partners in the Spiesman & Sons partnership during the years 1951, and 1952, within the meaning of sections 191 and 3797(a)(2) of the I.R.C. of 1939, as amended by section 340(a) and (b) of the Revenue Act of 1951.

MYRON E. ANDERSON, ESQ.,

For the Petitioners.

WENDELL M. BASYE, ESQ.,

For the Respondent.

Bruce, Judge: Respondent determined deficiencies in the income tax of the petitioners and additions to tax as follows:

Year	Deficiency	Additions to Tax Sec. 294(d)(2)
1951	\$ 2,155.22.....	\$356.93
1952	14,056.20.....	986.14

Respondent, on brief, has abandoned his determination that petitioners are liable for additions to tax for the years involved under section 294(d)(2) of the Internal Revenue Code of 1939. Petitioners, at the hearing and on brief, have conceded or abandoned all other issues raised by the pleadings except one. The only question presented is whether the five minor children of petitioners were partners in the Spiesman & Sons partnership during the years 1951, and 1952, within the meaning of sections 191 and 3797(a)(2) of the Internal Revenue Code of 1939, as amended by section 340(a) and (b) of the Revenue Act of 1951.

FINDINGS OF FACT

Some of the facts were stipulated and are included herein by this reference.

Petitioners are husband and wife residing at St. Maries, Idaho. They filed a joint Federal income tax return for the calendar year 1951 with the then collector of internal revenue for the district of Idaho, and for the calendar year 1952, with the district director of internal revenue, Boise, Idaho.

Prior to 1950, petitioner Mathew J. Spiesman, Jr. (hereinafter sometimes referred to as Spiesman) was the owner of certain gambling devices commonly known as slot machines. These machines were operated in a bar known as the Gem State Club under an agreement between Spiesman and the Club, whereby Spiesman received 20 per cent of the receipts from the slot machines. Spiesman was presi-

dent and manager of the Gem State Club, a corporation. In 1947 the legislature for the State of Idaho enacted a statute (S.L. 1947, C. 151; sections 50-1501 to 1510, inclusive, Idaho Code), subsequently declared unconstitutional¹ and repealed,² providing that it should be lawful for any person to own and operate coin-operated amusement devices within the corporate limits of any incorporated city or village, after having first procured a license as therein provided. The term "person" was defined to include "an individual person, partnership, corporation or association."

On February 1, 1950, Spiesman, Jr., and his father, Mathew J. Spiesman, Sr., entered into a partnership agreement for the purpose of carrying on the business of operating and maintaining coin-operated amusement devices. The agreement recited that "the assets to be taken over by the partnership are in the possession and owned by the partner, M. J. Spiesman, Jr." It further recited that "M. J. Spiesman, Sr., agrees to pay a sum equal to one-half the value of the assets;" that they should bear "equally between them all licenses, fees, permits and other expenses" required for the support and man-

¹State v. Village of Garden City (Dec. 23, 1953), 74 Idaho 513, 265 P. 2d 328, holding S. L. 1947, C. 151, declaring coin-operated devices as gambling devices but not lotteries, violated Art. 3, §20 of the Idaho constitution, since such devices are lotteries. See also State ex rel. Nielson v. City of Gooding, 75 Idaho 36, 266 P. 2d 655.

²S. L. 1953, C. 62, §1, p. 82.

agement of the business; and that profits from the business should be divided, one-third to Spiesman, Sr., and two-thirds to Spiesman, Jr.

Spiesman, Sr., now 80 years of age, had for several years been distributing part of his estate by making gifts of real estate, stocks and mortgages to Spiesman, Jr., and to the latter's five sons, whose names and date of birth are as follows:

Name	Date of Birth
Michael Joseph	October 21, 1940
Philip James	November 29, 1943
Leonard John	February 11, 1945
Mathew James III	July 3, 1946
Francis Edward	September 26, 1950

On December 1, 1951, a new partnership agreement was entered into between Spiesman, Sr., and Spiesman, Jr., individually and on behalf of his five minor sons, which (omitting the jurat) is as follows:

Partnership Agreement

This Agreement of Partnership, made in duplicate as of the first day of December, 1951, by and between Mathew James Spiesman, Sr., Mathew James Spiesman, Jr., Michael James [Joseph] Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, and Francis Edward Spiesman, all of St. Maries, Benewah County, Idaho,

Witnessseth, that the said parties have agreed and by these presents do agree to associate themselves as partners for the purpose of carrying on the business of operation and maintenance of coin-operated

amusement devices, and incidental concessions connected therewith, to the faithful performance of which they mutually bind and engage themselves, each to the other, their executors and administrators.

First: The name, style and title of such partnership shall be Spiesman & Sons,

Second: At the time of this agreement, the assets to be taken over by the partnership are in possession and owned by the partner[s], Mathew James Spiesman, Jr., [and Mathew J. Spiesman, Sr.] and are in the value of \$2,374.63. The capital of said partnership in addition to the aforementioned assets shall consist of cash contributions divided into nine equal shares, of which each of the partners shall own one-ninth, with the exception of the partner, Mathew James Spiesman, Jr., who shall own one-third of the shares. Further cash contributions shall consist of:

Michael James Spiesman	\$100.00
Mathew James Spiesman, III	100.00
Philip James Spiesman	100.00
Leonard John Spiesman	100.00
Francis Edward Spiesman	100.00

The capital of the partnership in addition to the initial cash contributions enumerated above shall also consist of the income and profits arising from the employment thereof, with the exception of that which each is entitled to withdraw as hereinafter provided. That said capital may at any time be reduced or extended by agreement between the parties hereto, and that the said capital, together with all

credits, goods, wares or commodities bought or obtained by the said firm, by barter or otherwise, shall be kept, used and employed in and about the business aforesaid.

Third: The term for which this partnership is organized is for an indefinite period from and after December 1, 1951.

Fourth: Duties of Partners. The partner, Mathew James Spiesman, Jr., shall be actively in charge of the business and shall assume the functions customarily performed and shall perform the duties as manager. He shall devote a major portion of his time, attention, experience and endeavors to said business. The partners, Mathew James Spiesman, Sr., Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman and Francis Edward Spiesman, shall and will at all times during the continuance of the partnership bear, pay and discharge equally with all partners all the licenses, fees, permits and other expenses that may be required for the support and maintenance of said business.

Fifth: Books of Account. That there shall be kept at all times during the continuance of the partnership, a perfect, just and true set of books of accounts, wherein each of the said partners shall enter and set down, as well all money by them, or any of them, received, paid, laid out, and expended in and about the said business, as also all the goods, wares, commodities, and merchandise by them, or any of

them, bought or sold, by reason or on account of the said business, and all other matters and things whatsoever to the said businesss and management thereof in anywise belonging; which said books shall be used in common between the said partners, so that any of them may have access thereto without any interruption or hindrance of any of the others; that the said partners quarterly during the continuance of the said partnership, as aforesaid, to wit, on the first day of January, April, July, and October in each year, or oftener if necessary, shall make, yield, and render, each to the other, a true, just and perfect inventory and account of all the profits and increase by them, or any of them, made and of all loss by them, or any of them, sustained; and also of all payments, receipts, and disbursements, and of all other things by them made, received, disbursed, acted, or suffered, in their said business, and the same account being so made, they shall and will clear and adjust, each to the other, at the time, their just share of the profits so made as aforesaid.

Sixth: Monies of the partnership shall be deposited in the Farmers & Merchants Bank, Rockford, Washington. All expenses of the business shall be first paid, and no partner is to draw any salary except out of the profits of the business. Accurate books shall be kept at all times. All bills and liabilities shall be paid by check and the books of the partnership shall be open to inspection of each partner at any time.

Seventh: Share in Profits. Periodically, at either

monthly or quarterly intervals, each partner shall be entitled to withdraw from the business as a salary an amount of income commensurate with the capital stock owned by them and the services which they have contributed; however, under no circumstances shall said withdrawals impair the operating capital of the partnership. No further withdrawals shall be made in the form of profit after payment of salaries to the partners until such time as all indebtedness owing by the partnership has been paid.

In addition to the above-mentioned share in the profits, the partner, Mathew James Spiesman, Jr., shall draw as salary for managing the partnership business the sum of Two Hundred Fifty (\$250) Dollars per month.

Eighth: Dissolution of Partnership. In the event of dissolution of the partnership by reason of death, withdrawal or any other act of any partner or partners before the expiration of said term, the remaining partner or partners may, if desired, have the right to purchase the interest or interests of said partner or partners in the business assets and good will by paying a reasonable value of such interest or interests. Upon such payment, the retiring partner or partners, or his representatives, or the representatives of his estate, shall execute and deliver to the remaining member or members all necessary conveyances of said interest or interests. The continuing member or members shall assume all of the existing firm obligations and shall be entitled to continue using the firm name unrestricted as to the

length of time during which it may be used or its sale or assignment.

Tenth [sic]: Acts Not to Be Done Without Consent. (a) None of the partners hereto during the continuance of this partnership shall assume any liability for another or others by means of endorsement or by becoming guarantor or surety or in any other manner even though not specifically mentioned herein, without first obtaining the consent of the other parties hereto in writing. (b) No partner shall have the authority to do any act in contravention of these Articles. (c) No partner shall have the authority to do any act that would make it impossible to carry on the ordinary business of the partnership. (d) No partner shall confess a judgment. (e) No partner shall have the authority or power to possess partnership property or assign their rights in specific partnership property for other than a partnership purpose. (f) No partner shall have the authority to admit any other person or persons as a general partner. (g) No partner shall have the authority to admit any person or persons as a limited partner unless the right to do so is agreed upon by all other partners in writing.

In Witness Whereof, the parties hereto have hereunto set their hands and seals the day and year in this partnership agreement first above written.

/s/ MATHEW JAMES SPIESMAN,

/s/ MATHEW JAMES SPIESMAN, JR.,

/s/ MICHAEL JOSEPH SPIESMAN,

/s/ MATHEW JAMES SPIESMAN, III,

/s/ PHILIP JAMES SPIESMAN,

/s/ LEONARD JOHN SPIESMAN,

/s/ FRANCIS EDW. SPIESMAN,

By /s/ M. J. SPIESMAN, JR.,

Guardian for Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, Francis Edward Spiesman.

[Brackets represent interlineations.]

The interlineations appearing in paragraph numbered "Second," were inserted by Spiesman, Jr., in 1953, after the initiation of the investigation of petitioners' income tax returns for the years involved. The \$100 cash contributions on behalf of each of the minor children were made by their father either from funds belonging to them or advanced by him.

A partnership return (Form 1065) was filed by Spiesman & Sons for the period beginning December 1, 1951, and ending January 1, 1952, showing net earnings in the amount of \$3,254.30, distributable as follows:

Mathew J. Spiesman, I	\$ 361.59
Mathew J. Spiesman, II	1,084.76
Mathew J. Spiesman, III	361.59
Philip Spiesman	361.59
Michael Joe Spiesman	361.59
Francis Spiesman	361.59
Leonard Spiesman	361.59

No withdrawals for this period were shown and the capital accounts of each of the above-named partners at the beginning of the period and at the end of the period were shown as follows:

	Beginning of Period	End of Period
Mathew J. Spiesman, I	\$ 100.00	\$ 461.59
Mathew J. Spiesman, II	2,774.63	3,859.39
Mathew J. Spiesman, III	100.00	461.59
Philip Spiesman	100.00	461.59
Michael Joe Spiesman	100.00	461.59
Francis Spiesman	100.00	461.59
Leonard Spiesman	100.00	461.59

A partnership return (Form 1065) was filed by Spiesman & Sons for the year 1952 showing net earnings in the amount of \$46,021.71, distributable as follows:

Mathew J. Spiesman, I	\$ 4,846.85
Mathew J. Spiesman, II	16,940.61*
Mathew J. Spiesman, III	4,846.85
Philip Spiesman	4,846.85
Michael Joe Spiesman	4,846.85
Francis Spiesman	4,846.85
Leonard Spiesman	4,846.85

*On briefs (request for finding number 9), petitioners assert, and respondent agrees, that "included in the \$16,940.61, distributable share of Mathew J. Spiesman, Jr., is salary for services rendered of \$2,400 and distribution of earnings of \$14,-540.61."

The capital accounts of each of the above-named partners at the beginning of the year, withdrawals, and the capital accounts at the end of the year were shown as follows:

	Capital Account at Beginning of Year	Withdrawals	Capital Account at End of Year
Mathew J. Spiesman, I	\$ 461.59	\$ 3,688.83	\$1,619.61
Mathew J. Spiesman, II	3,859.39	16,768.68	4,031.32
Mathew J. Spiesman, III ..	461.59	4,690.16	618.28
Philip Spiesman	461.59	2,592.80	2,715.64
Michael Joe Spiesman	461.59	2,593.25	2,715.19
Francis Spiesman	461.59	3,448.01	1,860.43
Leonard Spiesman	461.59	4,950.96	357.48

The income shown on the partnership returns was derived from the operation of the slot machines and other coin-operated amusement devices, most of which were located in the Gem State Club and continued to be operated under the original agreement as to percentages entered into between Spiesman and the Club prior to the formation of the partnerships between Spiesman and his father, and Spiesman & Sons. All licenses for the operation of the machines were obtained and paid for by the Gem State Club or other locations where they were placed. Spiesman spent about 3½ hours each day in the management of Spiesman & Sons' affairs. He was also manager of the Gem State Club, for which he received a salary of \$6,000 in 1951 and \$7,500 in 1952, and spent 6 to 7 hours each day in its management. Capital is a material income-producing factor of the Spiesman & Sons partnership. The salary paid Spiesman for managing the affairs of the partnership is reasonable.

Spiesman had been appointed guardian of the estates in his four minor sons, Michael Joseph, Philip James, Leonard John, and Mathew James, III, by the Probate Court of Benewah County,

Idaho, on April 17, 1947. He was appointed guardian of the estate of Francis Edward by the same court on October 13, 1953.

No opening or annual inventory and accounting reports of the estates of any of the minor children, as required by Sections 15-1825 and 15-1826 of the Idaho Code (1948), were filed by Spiesman as guardian during any of the years 1947 to 1952, inclusive; nor was there any supervision of the guardianship accounts otherwise exercised by the probate court during that period. On October 23, 1953, after the initiation of the investigation of petitioners' income tax returns for the years involved, Spiesman as guardian filed annual inventory and accounting reports of the estates of four of his sons, Mathew James, III, Philip James, Michael Joseph and Leonard John, for each of the years 1947 to 1952, inclusive. These reports were approved, allowed and settled by order of the Probate Court dated November 12, 1953. As he had not, prior to October 13, 1953, been appointed guardian of Francis Edward, no inventory or accounting report of the estate of Francis Edward was filed at that time. Annual inventory and accounting reports of the estates of all five of the children for the years 1953, 1954, and 1955 were filed in 1954, 1955, and 1956, respectively.

Withdrawals from the Spiesman & Sons partnership on behalf of each of the five minor children, during the year 1952, were made by Spiesman. According to the inventory and accounting reports filed by Spiesman as guardian of the estates of his

minor children, the following amounts were withdrawn from Spiesman & Sons on their behalf, respectively, during the years 1952 to 1955, inclusive:

	1952	1953	1954	1955
Mathew James	\$5,690.16	\$3,124.20	\$ 270.73	None
Philip James	1,592.80	3,557.13	2,005.33	None
Michael Joseph	1,593.25	3,626.12	1,936.62	None
Francis Edward ..(not shown)		3,079.35	291.94	None
Leonard John	3,848.01	3,500.16	269.85	None

Separate savings accounts for each of the minor children were opened in the Farmers & Merchants Bank of Rockford, Rockford, Washington, on March 17, 1952. Some of the funds withdrawn from the partnership on behalf of the children were deposited in their respective savings accounts; some were used to pay premiums on their individual life insurance policies; some were used to pay their income taxes; and occasionally some were used to purchase additional securities for them. None of these funds, insofar as the accounting reports filed with the Probate Court reveal, were used for the support or living expenses of any of the minor children.

On their income tax return for 1952, petitioners reported the sum of \$17,077.25 as partnership income, of which \$16,940.61 was received from Spiesman & Sons, and \$136.64 from Spiesman and Resor.

The five minor children of petitioners were not the owners of capital interests in the partnership and were not bona fide partners in the Spiesman & Sons partnership during the years 1951 and 1952.

Opinion

This is a family partnership case involving the question whether the five minor children of the petitioners were bona fide partners in the Spiesman & Sons partnership during the taxable years 1951 and 1952, within the meaning of Sections 191 and 3797 (a)(2) of the Internal Revenue Code of 1939, as amended by Sections 340(a) and (b) of the Revenue Act of 1951. Respondent has determined that they were not and accordingly included in petitioners' distributive share of the partnership income the amounts of \$1,807.95 for 1951 and \$24,234.25 for 1952, being the aggregate of the amounts shown on the partnership returns as distributable to the children. Petitioners contend that the children were bona fide partners having a 1/9th interest each, and that the above amounts were properly includable in the income of the children during said years.

Section 340(a) of the Revenue Act of 1951, amended Section 3797(a)(2) of the Internal Revenue Code of 1939, which defines the terms partnership and partners, by adding thereto the sentence, "A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not said interest was derived by purchase or gift from any other person." Section 340(b) of the Revenue Act of 1951 also amended the 1939 Code by adding thereto Section 191, which provides:

Sec. 191. Family Partnerships:

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purpose of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons.

These amendments, applicable to the years involved, were primarily for the purpose of clarification which the Congressional Committees deemed necessary to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which activated the transfer, at the same time providing specific safeguards against the use of the

partnership device to accomplish the deflection of income from the real owner.

The reports of the House Committee on Ways and Means (H. Rept. No. 586, 82nd Cong., 1st Sess., C.B. 1951-2, pp. 357, 380-381) and of the Senate Committee on Finance (S. Rept. No. 781, 82nd Cong., 1st Sess.; C.B. 1951-2, pp. 458, 485-487) state that the amendment relating to family partnerships is intended:

* * * to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. Your committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.

The reports point out, however, that:

The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering v. Clifford* (309 U.S. 351). The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between family members. Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny. All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

Not every restriction upon the complete and unfettered control by the donee of the property donated will be indicative of sham in the transaction. Contractual restrictions may be of the

character incident to the normal relationships among partners. Substantial powers may be retained by the transferor as a managing partner or in any other fiduciary capacity which, when considered in the light of all the circumstances, will not indicate any lack of true ownership in the transferee. In weighing the effect of a retention of any power upon the bona fides of a purported gift or sale, a power exercisable for the benefit of others must be distinguished from a power vested in the transferor for his own benefit.

* * *

Therefore the bill provides that in the case of any partnership interest created by gift the allocation of income according to the terms of the partnership agreement shall be controlling for income tax purposes except when the shares are allocated without proper allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the allocation to the donated capital is proportionately greater than that attributable to the donor's capital. In such cases a reasonable allowance will be made for the services rendered by the partners, and the balance of the income will be allocated according to the amount of capital which the several partners have invested. * * *

Respondent argues that the five minor children of petitioners were not bona fide owners of capital in-

terests in the partnership during the years 1951 and 1952 for the reasons that there was no accounting to or supervision by the Probate Court of the guardianship estates during these years, and, under the licensing provisions of the Idaho statute the children could not be treated as the real owners of a capital interest in the slot machines. Respondent further argues that the participation of the minor children in the slot machine business was illegal in Idaho and, therefore, they should not be recognized as the real owners of a capital interest in the partnership business.

The proper accounting for a ward's estate by a fiduciary is primarily a matter for the state court to determine. In view of our conclusions hereinafter discussed, we need not, and do not, here determine whether the filing by a fiduciary of such accountings and reports as are required by state law is a necessary condition of the recognition of a minor as a member of a partnership. Section 29.191-1 of Regulations 111, as carried forward into Section 39.191-1 of Regulations 118, referred to by respondent, was not promulgated until August 18, 1953. See T.D. 6037, C.B. 1953-2, p. 213. We have no doubt, however, that the filing or failure to file such accountings and reports may be considered, as a fact and circumstance following the purported gift, in determining the bona fides or lack of bona fides of a purported gift or sale, and we have done so in our determination.

With respect to the legality of the transaction,

Section 50-1503 of the Idaho Code (S.L. 1947, C. 151), later declared unconstitutional and repealed,³ provided that it should be lawful for any person to own and operate coin-operated amusement devices within the limits of any incorporated city or village only, and after having first procured a license as thereafter provided. Section 50-1504 provided that no coin-operated amusement device might be operated on any premises except those owned or leased by the licensee, and, further, that no person other than the licensee "may have any legal, equitable or financial, title or interest in such device, whether by ownership, mortgage, conditional sales contract, or otherwise, nor receive any rent or remuneration therefrom or from the operation thereof." It is also to be noted that Section 50-1509 made it unlawful to "possess or permit operation" of such devices without license having first been procured as therein provided.

The machines here in question were operated on the premises of the Gem State Club, or other locations, not shown to have been owned or leased by petitioners, the partnership or any of the parties to the Spiesman & Sons partnership agreement. All licenses were obtained and paid for by the Gem State Club or other locations. It is clear, therefore, that, even if the Idaho statute under which they purported to act had not been declared unconstitutional and repealed, the minor children of petitioners cannot be considered as having any "legal,

³See Footnotes 1 and 2.

equitable or financial, title or interest" in such devices and that they could not legally "receive any rent or remuneration" from the operation of such devices.

Both Spiesman and his father testified that the reason for the purported gifts to the children was for the purpose of making them partners in the business of the Spiesman & Sons partnership. In *E. C. Ellery*, 4 T.C. 407, we held that since the gifts in that case were expressly or impliedly conditioned on the formation of a partnership which could not be formed because of the illegality of its business under the state law, the gifts failed at the outset. The same rule applies here.

Aside from the foregoing, however, we think it clear that there were no bona fide gifts of interests in the machines, which were the income-producing assets of the partnership, to the children, and the formation of the Spiesman & Sons partnership was a sham. The partnership agreement (Petitioner's Exhibit 10) recited that, "At the time of this agreement, the assets to be taken over by the partnership are in possession and owned by the partner, Mathew James Spiesman, Jr., and are in the value of \$2,374.63." The original typewritten agreement, after the initiation of the investigation of petitioners' income tax returns involved herein, was interlined to indicate that Spiesman and his father each owned a half interest in such assets at the time of this agreement. Whether such assets were owned by one or both is immaterial, so far as the children are

concerned. Petitioners claim that each of the children received a $1/9$ th interest in such assets upon the execution of the partnership agreement and therefore was entitled to receive $1/9$ th of the distributable income. The facts shown do not support this contention.

The partnership agreement itself is, to say the least, inconclusive with respect to the transfer of title to the machines. It does not appear that there were any other written transfers of title and the books and records of the partnership were not placed in evidence. It appears, however, from the partnership return (Form 1065) filed by Spiesman & Sons for the period beginning December 1, 1951, and ending January 1, 1952, as well as the return for the year 1952, that the full value of the machines was shown as included in the capital account of the petitioner, and no interest in such machines was included in the capital account of any of the children.

Moreover, the partnership returns show that withdrawals on behalf of the children were not equal for the year 1952, as they should have been if the children each owned a $1/9$ th interest in the capital assets. The unequal treatment of the children with respect to withdrawals from the partnership is likewise shown by the accounting reports filed by Spiesman as guardian for 1952, 1953, and 1954. In some instances the amount withdrawn was in excess of the purported distributable share of the child, and in other instances it was less. Spiesman explained such discrepancies as follows:

* * * the difference in the amount of money withdrawn was due to the fact that Joe, the oldest boy, and Phil, the next oldest boy, had income from dividend stocks prior to the, and more stock, than the other children, and I tried to even up—at that time I tried to even up the cash account of each child, so that if I had an accident, why, or I got killed or died, my youngest child wouldn't say, "Well, my dad wasn't very fond of me; he didn't leave me anything," and I didn't want to have that happen and I wanted them to be even as far as cash was concerned, and then they would eventually receive stock or whatever my dad was going to leave them when he died. But the cash account I tried to even up.

However commendable such treatment of his children by a father may be, the fact remains that it did not conform to the purported partnership interests of the children, or to his duties as a guardian if such partnership interests were bona fide; it was the action of a parent who owned, controlled and distributed his own funds according to his own desires and ideas.

The question to be determined herein is one of fact to be determined from all the facts and circumstances. As stated in the reports of the Senate and House Committees, *supra*, "All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona

fides or lack of bona fides of a purported gift or sale." See also *Commissioner v. Culbertson*, 337 U.S. 733, wherein the Supreme Court said that the question whether a partnership exists for income tax purposes is:

* * * whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise. * * *

Considering all the facts and circumstances herein we hold that the five minor children of the petitioners were not the real owners of capital interests in the partnership and were not bona fide partners in the Spiesman & Sons partnership during the taxable years 1951 and 1952.

Inasmuch as respondent has abandoned his determination that the petitioners are liable for additions to tax for the years involved under Section 294(d) (2) of the Internal Revenue Code of 1939,

Decision will be entered finding petitioners liable for deficiencies in income tax in the

amount of \$2,155.22 for the year 1951, and in the amount of \$14,056.20 for the year 1952.

Reviewed by the Court.

Filed May 31, 1957, U.S.T.C.

Served June 4, 1957.

Entered June 4, 1957.

The Tax Court of the United States, Washington

Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed May 31, 1957, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1951 and 1952 in the amounts of \$2,155.22 and \$14,056.20, respectively.

/s/ J. GREGORY BRUCE,
Judge.

Served June 7, 1957.

Entered June 7, 1957.

[Title of Tax Court and Cause.]

ORDER AMENDING DECISION

For cause appearing of record, it is

Ordered that the decision entered in the above-entitled cause on June 5, 1957, be, and it is hereby amended by changing the final period to a comma and adding thereto the phrase: "and that there are no additions to tax under Section 294(d)(2) of the Internal Revenue Code of 1939 for the years 1951 and 1952," and that as thus amended the second paragraph of said decision shall read as follows:

"Ordered and decided: That there are deficiencies in income tax for the years 1951 and 1952 in the amounts of \$2,155.22 and \$14,056.20, respectively, and that there are no additions to tax under Section 294(d)(2) of the Internal Revenue Code of 1939 for the years 1951 and 1952."

It is further Ordered that the decision entered June 5, 1957, remain the same in all other respects.

Dated: August 27, 1957.

[Seal] /s/ J. GREGORY BRUCE,
 Judge.

Served August 29, 1957.

Entered August 29, 1957.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW

Mathew J. Spiesman, Jr., and Mary Spiesman, Petitioners in this cause, hereby file their Petition for Review, by the United States Court of Appeals for the Ninth Circuit, of the decision by the Tax Court of the United States entered on June 5, 1957, reported at 28 TC No. 62, determining deficiencies in the Petitioners' federal income taxes for the calendar years 1951 and 1952 in the respective amounts of \$2,155.22 and \$14,056.20. This Petition for Review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code. The Petitioners respectfully show as follows:

I.

Allegations of Venue

The Petitioners are husband and wife with principal address being St. Maries, Idaho. For the calendar year 1951, Petitioners filed a joint income tax

return with the then Collector of Internal Revenue for the District of Idaho, and for the calendar year 1952 Petitioners filed a joint income tax return with the District Director of Internal Revenue, Boise, Idaho.

II.

Nature of the Controversy

Prior to 1950, Petitioner, Mathew J. Spiesman, Jr. (when Petitioner is referred to in the singular, it will refer to Petitioner Mathew J. Spiesman, Jr.), was the owner of certain coin-operated amusement devices (hereinafter sometimes referred to as the machines). Petitioner was also the president of the Gem State Club, an Idaho corporation. Petitioner Mathew J. Spiesman, Jr., entered into an agreement with the Gem State Club whereby the machines referred to above were operated on the premises of the said corporation with the Petitioner, Mathew J. Spiesman, Jr., receiving 20 per cent of the total receipts from the machines.

The machines owned by Mathew J. Spiesman, Jr., Petitioner herein, were transferred to a partnership in February of 1950, known as Spiesman & Spiesman, said partnership being between Mathew J. Spiesman, Jr., and his father, Mathew J. Spiesman, Sr. Mathew J. Spiesman, Sr., paid into the partnership one-half the value of the machines contributed by the other partner, Mathew J. Spiesman, Jr., and received one-third the profits of the said partnership. The other two-thirds of the partnership profit were distributed to Mathew J. Spiesman, Jr.

On the 1st day of December, 1951, a new partnership was formed between Mathew J. Spiesman, Jr., Mathew J. Spiesman, Sr., and the five minor children of Mathew J. Spiesman, Jr., and Mary Spiesman, the Petitioners herein. The names and the birthdays of the five children who composed the additional partners in the partnership known as Spiesman & Sons are as follows:

Name	Date of Birth
Michael Joseph	October 21, 1940
Philip James	November 29, 1943
Leonard John	February 11, 1945
Mathew James, III.	July 3, 1946
Francis Edward	September 26, 1950

Mathew J. Spiesman, Jr., was the legally appointed guardian for the five children mentioned above. In the formation of the Spiesman & Sons partnership referred to above, the above-named five children of the Petitioners herein each contributed \$100 to the partnership. The \$100 contribution to capital made by the children was by and through Mathew J. Spiesman, Jr., the legally appointed guardian of the children. The money came either from the children's individual funds or was advanced to them by Mathew J. Spiesman, Jr., for this purpose.

During the taxable years 1951 and 1952, the partnership Spiesman & Sons showed a profit. Tax returns were filed for those taxable years showing the profit and showing the said profit as a distribution

to the individual partners referred to above. The funds from the partnership profit which went to the minor children of Petitioners herein were deposited in separate savings accounts which were opened in the Farmers and Merchants Bank of Rockford in Rockford, Washington, for this specific purpose. Some of the funds were used to pay premiums on the life insurance policy of the children; some of the funds were used to pay income taxes and some of the funds were used to purchase securities for the said children. None of the funds were used for the support or maintenance or living expense of the said minor children of Petitioners herein.

The Petitioners for the taxable years 1951 and 1952 in filing their joint income tax return, reported thereon only their distributable share of the partnership income from the partnership Spiesman & Sons during these taxable years. The Commissioner of Internal Revenue, however, asserted that the partnership was invalid for tax purposes claiming that it was not a bona fide family partnership for the purpose of reporting income.

The Commissioner therefore took the entire partnership income, including the income distributed by the partnership to Mathew J. Spiesman, Sr., and taxed the entire amount to Petitioners herein. The Tax Court of the United States in the opinion referred to above held that although capital was an income-producing factor of the Spiesman & Sons partnership, the five minor children of Petitioners were not owners of a capital interest in the partner-

ship and were not bona fide partners in Spiesman & Sons during the taxable years 1951 and 1952.

III.

The said Petitioners being aggravated by the findings of facts and conclusions of law contained in the said findings and opinion of the Court as referred to above and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit. The five minor children of Petitioners were bona fide partners of Spiesman & Sons during each of the calendar years 1951 and 1952.

/s/ PAUL CASTOLDI,

/s/ FRANCIS J. BUTLER,

Counsel for Petitioners.

Duly verified.

Affidavit of Service by Mail attached.

Received and filed August 30, 1957, T.C.U.S.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

Nelson P. Rose,
Chief Counsel,
Internal Revenue Service,
Washington, D. C.

Dear Sir:

You are hereby notified that the Petitioners on the 30th day of August, 1957, filed with the Clerk

of the Tax Court of the United States, Washington, D. C., a Petition for Review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the assignment of error as filed is attached hereto and served upon you.

Dated at Spokane, Washington, this 28th day of August, 1957.

Respectfully,

/s/ PAUL CASTOLDI,

/s/ FRANCIS J. BUTLER.

Service of copy acknowledged.

Received and filed September 5, 1957, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 28, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record," including joint Exhibits 1-A through 7-G, attached to stipulation of facts; petitioners' Exhibits 8 through 14, 16 through 21, admitted in evidence (petitioners' Exhibits 15 and 22, marked for

identification and not left with the record), respondent's Exhibits H through N, admitted in evidence, in the case before the Tax Court of the United States docketed at the above number and in which the petitioners in the Tax Court case have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 24th day of September, 1957.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 15752. United States Court of Appeals for the Ninth Circuit. Mathew J. Spiesman, Jr., and Mary Spiesman, Petitioners, vs. Commissioner of Internal Revenue, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed October 8, 1957.

Docketed October 16, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 56141

MATHEW J. SPIESMAN, JR., and MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STATEMENT OF POINTS TO BE RELIED
UPON BY PETITIONERS

The above-named petitioner-appellants intend to rely upon the following points on their appeal from the decision of the Tax Court of the United States to the United States Court of Appeals for the Ninth Circuit:

1. The findings of fact made by the Tax Court of the United States in the above-entitled cause are erroneous in the following particulars:

(a) The Tax Court of the United States erred in finding that the five children of Petitioners were not the owners of capital interests in Spiesman & Sons partnership and were not bona fide members of Spiesman & Sons partnership during the taxable years 1951 and 1952.

(b) The Tax Court of the United States erred in failing to find that Mathew J. Spiesman, Sr., was

a bona fide member of Spiesman & Sons, a partnership, during the years 1951 and 1952.

2. The Tax Court of the United States erred in finding that the Petitioners were liable for deficiencies in income tax for either of the years 1951 and 1952.

/s/ PAUL CASTOLDI,

/s/ FRANCIS J. BUTLER.

Affidavit of Service by Mail attached.

[Endorsed]: Filed October 23, 1957, U.S.C.A.

No. 15752

United States Court of Appeals
For the Ninth Circuit

MATHEW J. SPIESMAN, JR., AND MARY SPIESMAN,
Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

*Appeal from the Tax Court of the
United States*

BRIEF FOR PETITIONERS

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Attorneys for Petitioners.

THE FRANKLIN PRESS, SPOKANE

FILED

JAN 24 1958

No. 15752

United States Court of Appeals
For the Ninth Circuit

MATHEW J. SPIESMAN, JR., AND MARY SPIESMAN,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
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*Appeal from the Tax Court of the
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United States Court of Appeals

For the Ninth Circuit

MATHEW J. SPIESMAN, JR., AND MARY
SPIESMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 15752

*Appeal from the Tax Court of the
United States*

BRIEF FOR PETITIONERS

JURISDICTIONAL STATEMENT

The Tax Court of the United States, in a written opinion reviewed by the full Court (28 T.C. No. 62), held adversely to Petitioners herein under date of May 31, 1957. The decision of the Tax Court of the United States was entered June 4, 1957. An order amending the said decision was entered August 27, 1957. Petitioners herein filed a Petition for Review with the Circuit Court of Appeals for the Ninth Circuit on the 30th day of August, 1957. A copy of said Petition together with a Notice of Filing Petition for Review was filed with the Chief Counsel, Internal Revenue Service, Washington, D. C. The returns for the periods here involved were filed with the District Director of Internal Revenue for the State of Idaho.

This Court has jurisdiction on appeal from the decision of the Tax Court of the United States by virtue of Section 7482 of the Internal Revenue Code of 1954.

STATEMENT OF THE CASE

The question involved in this proceeding is the validity of the family partnership entered into between Petitioner Mathew J. Spiesman, Jr., his five children, and his father. The taxable years involved are the years 1951 and 1952. The Tax Court of the United States held that the said partnership was invalid.

Mathew J. Spiesman, Jr., Petitioner herein (Mrs. Mathew J. Spiesman, Jr., Mary Spiesman is a petitioner in this proceeding only by virtue of filing a joint income tax return for the taxable years involved with her husband. For the sake of convenience, reference to Petitioner will be used in the singular since Mathew J. Spiesman, Jr., is the principal party included in the discussion of the case) returned to St. Maries, Idaho, upon the death of his mother in 1937. At that time he evidenced a desire to retire from professional baseball. Mathew J. Spiesman, Sr. (sometimes referred to as Petitioner's father), who at the time of the hearing in this case was eighty years old, had retired from business some time in 1935. Petitioner's father established Petitioner in business by advancing the money with which the Petitioner purchased a one-half interest in his father's old business and formed a partnership for the conduct of a bar with one Resor.

In February of 1950, prior to the taxable years involved herein, Petitioner and his father formed a partnership known as Spiesman & Spiesman. Prior to the formation of this partnership, Petitioner had

owned several slot machines and other coin-operated amusement devices. Petitioner's father purchased a one-half interest in these machines and other coin-operated amusement devices and they thereupon transferred the same to the Spiesman & Spiesman partnership. Petitioner also transferred to the partnership an agreement which Petitioner had with the Gem State Club, a corporation of which he was president. The agreement with the Gem State Club was that the machines and other coin-operated amusement devices would be left on the premises of the Gem State Club for operation and the Petitioner would maintain the machines and receive for service and rental 20 per cent of the total receipts. This agreement covered all coin-operated amusement devices. Spiesman & Spiesman operated under this agreement until December of 1951. The partnership of Spiesman & Spiesman, although somewhat material to a discussion of the facts herein, is not in any way involved in this controversy.

Some time in October of 1951, Petitioner's father read an article in the U. S. News and World Report entitled "Partnership Within the Family May Save Tax." The article was an explanation of the changes made by Congress in the 1951 Revenue law liberalizing the rules governing the taxation of so-called "family partnerships."

Petitioner at this time was the father of five children who were born on the following dates:

<i>Name</i>	<i>Date of Birth</i>
Michael Joseph	October 21, 1940
Philip James	November 29, 1943
Leonard John	February 11, 1945
Mathew James III	July 3, 1946
Francis Edward	September 26, 1950

Petitioner's father a number of years earlier had embarked upon a program of gifts to Petitioner and to his five children. The purpose of the gifts were to avoid the legal work upon probate. Petitioner's father attempted over a period of years, beginning in 1945, to equalize the gifts among the children and provided for future equalization in his will.

Petitioner's father, based upon information gleaned from the article in the U. S. News and World Report, referred to above, suggested the possibility to Petitioner of a so-called family partnership. Petitioner, after listening to his father and reading the article in the U. S. World Report, was not certain. Petitioner, however, at his father's insistence, took a trip to Boise, Idaho, and consulted an attorney concerning the legal aspects of the so-called family partnership form of doing business under the changes that had been made in the law in 1951. The attorney being unable to answer the question, directed the Petitioner to the Internal Revenue Service office for information. The Internal Revenue Service informed Petitioner that they were not in a position to give him

a ruling or any advice as to the validity of the family partnership under the new law, but called to his attention the provisions of the law which were then applicable (Section 191 and Section 3797(a)(2) of the Internal Revenue Code of 1939 as amended by Section 340(a) and (b) of the Internal Revenue Act of 1951). Petitioner took the quoted sections which had been offered him by the Internal Revenue Service and returned to the lawyer, who after having read the sections informed the Petitioner that under the circumstances a family partnership would be perfectly legal. At this time the Petitioner informed the attorney that the partnership would be in the con-operated amusement device business.

Under date of December 1, 1951, Petitioner's father, and Petitioner's five children formed a new partnership known as Spiesman & Sons. It is the validity of this partnership which is the cause of the interest in controversy.

In the formation of a new partnership Spiesman & Sons, Petitioner's father gave to each child a proportionate share of all but one-ninth of his interest in the equipment and/or his partnership interest, of the partnership Spiesman & Spiesman; Petitioner gave the children all but one-third of his interest so that the partnership was owned six-ninths by Petitioner's father and Petitioner's five children (each party owning one-ninth), and three-ninths by Petitioner and his wife. There is no question that the

partnership income tax returns for the two taxable years involved herein reflect this distributive share of partnership income.

The income from Spiesman & Sons came from the 20 per cent of the receipts received under the leasing agreement that Petitioner had with the Gem State Club and which Petitioner had assigned to the new partnership. At the end of 1951, and again in 1952, the income was allocated among the partners according to their interest in the partnership. The partnership information returns reflect such distribution. The money which was allocated to each child based upon his distributive share found its way into one of four places: The money was placed in Merchants Bank of Rockford, Washington; or used to buy securities for the children; or used to pay the income taxes of the children; or used to pay insurance premiums of the children. In subsequent years, some of the money (\$500) was also used as an additional contribution to capital of the partnership when such additional capital became necessary when the Supreme Court of the State of Idaho held that coin-operated amusement devices violated the state constitution. However, during the taxable years involved herein, the machines were legal under Idaho State law. None of the amounts were expended in any way for the support of the children.

Petitioner was appointed guardian for his four oldest children on April 17, 1947. Letters of guardianship were issued in the Probate Court of Benewah

County, State of Idaho. Letters of guardianship were issued for Francis Edward Spiesman, Petitioner's youngest son, under date of October 13, 1953. Petitioner was appointed guardian of the four oldest children at the request of the Bunker Hill and Sullivan Mining Company, who made such request so that the dividend checks which were issued to the children could be cashed by their father. The Bunker Hill and Sullivan Mining stock and other stocks had been transferred to the children as a gift by their grandfather prior to the formation of any of the partnerships involved herein. During the early years of the guardianship, Petitioner had purchased bonds and other stocks and put them in the name of each child without himself being named as co-owner. All the funds collected by the Petitioner were held or expended for the children.

At the time the Internal Revenue Service started their investigation, Petitioner had not filed an inventory and accounting for said guardianship. Prior to this time he had not been advised to do so or advised of the necessity to do so by his attorney. At the suggestion of the probate judge in Benewah County, the Petitioner did file an inventory and accounting for the said children. The first inventory and accounting filed was under date of October 23, 1953, and covered the years 1947 through December 31, 1952. Subsequent to this, accountings were filed for each of the years 1953, 1954 and 1955. The Probate Court of Benewah County issued an order settling the inventory and account and report of guardian under date

of November 12, 1953. At that time, all of the actions of the guardian were given court sanction. The Court said:

“And the Court having examined the said beginning inventories with respect to each of the said wards and the Court having further examined the subsequent annual inventory and accountings filed by said guardian, and it appearing to the court that all the statements in said inventories as filed by said guardian are true and correct, and that the subsequent accountings were true and correct, and it further appearing to the court that the administration of said guardianship of said minor wards has been regular and proper and has been conducted to the best interests of said minor wards,

“IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED that the said inventories heretofore filed by the said M. J. Spiesman, Jr., setting out the assets which were acquired by the said guardian at the inception of said guardianship, be and the same are hereby approved, allowed and settled.”

During the years involved herein in which the partnership was also involved (taxable years 1951 and 1952), the Petitioner as guardian withdrew unequal amounts from the partnership and deposited these amounts to the respective account of each child. However, during this period, the partnership returns filed on behalf of the partnership, showed an equal distribution of income and the children of the Petitioner filed income tax returns reflecting this amount. This

unequal withdrawal was done at Petitioner's own volition in an effort to equalize cash accounts. Subsequent to this time Petitioner, after noting his mistake, evened the unequal withdrawals and (though the partnership is still in existence), the record indicates that each child has substantially equal amounts in the savings account as of 1956.

The Internal Revenue Service assessed deficiencies against Petitioner for each of the taxable years 1951 and 1952 based on the theory that the so-called family partnership was invalid. In so doing, the Government took *all* of the partnership income allocable to the children and taxed it back to the Petitioner. No effort was made to tax any of the income allocable to the children to the Petitioner's father who had made the gifts to the children in the first instance. The Government's theory of the case set out in the statutory notice of deficiency said simply the following:

“That the earnings of the business, Spiesman & Sons, are primarily attributable to the services of Mathew J. Spiesman, Jr., and your capital contribution; and further, that to no substantial extent are such earnings attributable to either capital or services of any of said minor children.”

The identical language is used in the statutory notice for both taxable years involved herein.

The Petitioner at the hearing in his opening statement set forth as his basic contention the family partnership and as an alternative the fact that the income of the children had not been taxed back to the Petitioner's

father instead of Petitioner. The Internal Revenue Service maintained: that the interest of the children in the partnership didn't coincide with tests laid down in Treasury Regulations 118.39.191(B)(8); that the Idaho law prevented the child from owning any interest in coin-operated machines, and lastly that "to no substantial extent are the earnings of the business attributable to either capital or services of the five minor children."

The Tax Court of the United States in its opinion (28 TC No. 62) found as a fact that capital was an income-producing factor of the Spiesman & Sons partnership; that the salary paid to Mathew J. Spiesman, Jr., by the partnership was reasonable; that amounts were withdrawn from the partnership on behalf of the children; that of the funds so withdrawn, some were deposited in savings accounts for the children; some were used to pay premiums on the children's life insurance, taxes, and to purchase securities for them. Ultimately, however, the Court found as a fact that the interests of the five minor children in the Spiesman & Sons partnership were not bona fide during the taxable years 1951 and 1952. The reasoning of the Tax Court is not clear but the crux of the opinion is well set forth in the following excerpt from said opinion: "We think it clear that there were no bona fide gifts of interest in the machines, which were the income-producing assets of the partnership, to the children, and the formation of the Spiesman & Sons partnership was a *sham*." (Emphasis supplied.) The Tax Court of the United States erred in so holding.

If the facts of record prior, during and subsequent to the formation of the family partnership involved herein are considered in the light of the changes made by Congress in Sec. 340(a) and (b) of the Revenue Act of 1951 and under the arguments set forth herein, the partnership Spiesman & Sons was a valid partnership for income tax purposes.

SPECIFICATIONS OF ERROR

I

The Tax Court of the United States erred in its finding that the partnership Spiesman & Sons was not a valid family partnership for federal income tax purposes since it failed, in so finding, to give full import to Section 340(a) and (b) of the Revenue Act of 1951, which said section changed the law regarding the taxation of family partnerships, and because the facts of record would not justify the specific holding that the said partnership was a sham.

II

The Tax Court of the United States erred in their interpretation of the facts upon which they relied in making their ultimate finding that the partnership Spiesman & Sons was not a valid family partnership for income tax purposes for the taxable years 1950 and 1951. Specifically, the Tax Court erred:

(a) In placing any reliance upon the partnership agreement and the interlineations appearing therein because the said agreement, as augmented by oral testimony, represents the true intention of the parties and

contains no limitations upon the distribution of income or other limitations which would preclude a finding that the partnership was valid for federal income tax purposes ;

(b) In relying upon the partnership income tax returns of Spiesman & Sons for the taxable years included herein, in determining the ownership of the coin-operated amusement devices because the capital accounts contained in the schedules in the said partnership return are erroneous based upon the admitted facts of record, and further that the unequal withdrawals of the children are immaterial since it is the undisputed equal distribution of partnership income which each said minor received from the partnership and, which is reflected in the said tax returns, which is material and determinative for federal income tax purposes ;

(c) In not recognizing that the guardianship inventory and accounting reports as filed by Petitioner on behalf of the said minor children, though filed late, were nonetheless indicative of the fact that the partnership and the distribution of partnership income was valid since the said accountings established that Petitioner never used any of the money for his own purpose and since the said reports were approved in every way by the State Court ;

(d) In relying upon the rationale of the *Culbertson* case since that case was specifically overruled or limited by the Revenue Act of 1951 which governs this proceeding.

III

The Tax Court of the United States erred in placing any reliance upon the following facts in making their ultimate determination that the partnership Spiesman & Sons was invalid for federal income tax purposes:

(a) The partnership accounting since if this is to be a factor, the finding of the Probate Judge of Idaho supports the validity of the partnership;

(b) The Idaho law since said law is not controlling in the instant case but if controlling on the validity of the partnership, is a further factor in substantiating the Petitioner's contention herein;

(c) The Tax Court case of *E. C. Ellery*, since that opinion is not factually compatible with the instant case.

IV

The Tax Court of the United States erred in holding that the entire income of the minor children in the partnership Spiesman & Sons should be taxed to the Petitioner, herein, rather than allocating the income back to Petitioner and Petitioner's father in proportion to the original gifts made herein.

INTRODUCTION TO ARGUMENT

The instant case involves the oft litigated, much written about question of the validity of a family partnership for federal income tax purposes. Its only

claim to significance is found in the fact that this is apparently the first Tax Court holding under the statutes which Congress enacted in 1951 which were intended to *liberalize* the whole law pertaining to the federal taxation of family partnerships. The history of the question needs no comment. The names *Tower* (*Commissioner v. Tower*, 327 U. S. 280) and *Culbertson* (*Commissioner v. Culbertson*, 337 U. S. 733), need no introduction. Suffice to say, that the Internal Revenue Service and the courts in general found uncertainty in the wake of the Supreme Court's decision in the *Culbertson* case. The courts were crowded with family partnership disputes and the taxpayers were left to ponder the question of whether their partnership device would be recognized under the various tests promulgated by the courts and the Internal Revenue Service. The whole state of the law was dependent upon so many factors that it was virtually impossible for a tax practitioner to advise for or against the formation and use of a device which found its way into the law as a device employed by high bracket taxpayers to climb down the surtax ladder. It finds its justification in the fact that a taxpayer can employ any legal method in order to minimize his tax burden.

It was with this confusion in mind that the First Session of the 82nd Congress undertook to clear the smoke and formulate some ground rules which could clear the way for the use of the family partnership device. The lead sentence in the Senate committee reports which accompanied the Revenue Act of 1951 best illustrate the intent: (S. Rept. No. 781, 82nd Cong. 1st Sess; C.B. 1951-2 p. 458 at p. 485)

“Section 339 of your committee’s bill is intended to harmonize the rules governing interests in the so-called family partnerships with those generally applicable to other forms of property or business.”

The fact that the family partnership resulted in a tax saving was supposedly nondeterminable. There is no question that this case comes within the amendments made by Congress to the 1939 Revenue Act by Section 340(a) and (b) of the Revenue Act of 1951. The only question is the effect of the provision when applied to the facts herein.

ARGUMENT

Argument on Specification of Error Number I.

Congress in order to harmonize the rules governing interest in so-called family partnerships enacted Section 340 (a) and (b) of the Internal Revenue Act of 1951. This section amended Section 3797 (a) (2) of the Internal Revenue Code of 1939, which defines partnerships to include the following:

“A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.”

In addition to the above, the Reveune Act of 1951 added a new section (Section 191 of the Internal Revenue Code of 1939) which provided as follows:

“In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor’s capital. . . .”

In the instant case, the Tax Court of the United States after recognizing the applicability of the 1951 Revenue Act to the instant proceeding found as a fact that the gifts of an interest in the slot machines and other coin-operated amusement devices involved herein and/or the partnership interest to the minor children of Petitioner were not bona fide and the formation of Spiesman & Sons partnership was a sham (T. 182). This is the crux of the Tax Court finding.

The first inquiry is whether the Tax Court of the United States can make such a finding under the changes made to the law by the 1951 Revenue Act. Certainly it must be recognized that if the new law had any effect at all, the Tax Court is not permitted to disregard it in arriving at its ultimate finding.

The Senate Committee on Finance reports accompanying the above bill (S. Rept. No. 781, 82nd Cong., 1st Sess.; C.B. 1951-2 pp. 485) mention two instances where the Courts can inquire into the validity of the arrangement. The report states as follows:

“The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferror purports to have given or sold him. Cases will arise where the gifts or sale is a mere sham. Other cases will arise where the transferror retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering v. Clifford* (309 U. S. 351). The same standards apply in determining the bona fides of alleged family partnerships as in determining the fides of other transactions between family members. Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny. All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.”

In its decision, the Tax Court of the United States resolved many of the problems in favor of the Petitioner which might have arisen under the Revenue Act of 1951, i.e., that capital was a material income-producing factor of Spiesman & Sons; that the salary paid to Petitioner was reasonable; (T. 172) that the income received by the children was used for their benefit to buy bonds, stocks, and pay taxes and that none of the said income was used for the support or

living expenses of any of the minor children (T. 174). The only question left for discussion is whether the gifts were bona fide and whether or not the partnership was a sham. The other factors mentioned by the Court and assigned herein as error will await discussion.

The Tax Court erred on the record in finding that the partnership of Spiesman & Sons was a sham. As the committee reports clearly indicate, (see above) the court in arriving at this conclusion must look at events both *before, surrounding* and *subsequent* to the formation of the partnership.

The events before the formation of the partnership clearly indicate that it wasn't a sham and the subsequent events lend much credence to the position taken by the Petitioner's herein on appeal.

It must be remembered that Petitioner and his father were doing business as a partnership when the instant partnership was formed (Ex. 9). The validity of the original partnership is not questioned. The Petitioner and his father first got the idea of a family partnership from an article appearing in a weekly magazine, the U. S. News and World Report (Ex. 8, T. 56, 85). Many pains were taken to check on the validity of this article before the partnership was formed. Petitioner made a special trip to consult an attorney concerning the validity of a family partnership. The attorney sent the Petitioner to the Internal Revenue Service which refused to make any predictions as to the validity of such an arrangement but

gave the Petitioner at that time a copy of the new law for him to read. Petitioner took the copy of the new law and after showing this to his attorney and after explaining to the attorney that slot machines would be used in the partnership, was informed that such partnership would be entirely valid under the tax laws (T. 85, 86). It must be remembered here that slot machines were legal in the State of Idaho during the years involved herein, being recognized by Sec. 50-1503 of the Idaho Code (S.L. 1947, C. 151), now repealed.

After being advised by the attorney that such a partnership would be valid, a partnership was formed. The partnership agreement was duly executed and signed by all the parties (Plaintiff who was the legally appointed guardian of four of the children signed on their behalf) (Ex. 10).

The Tax Court made much of the fact that the partnership agreement contained pencil changes (T. 170, 182). Yet the changes were made to reflect what must have been quite clearly the intent of the parties (T. 65). The changes merely reflected the true facts as established by the records. If the agreement prior to the change were to be taken at its face, Petitioner's father contributed nothing. Yet the uncontroverted facts show that he did own a one-half interest in the machines immediately prior to the time that Spiesman & Sons was formed. Petitioner's father had purchased a half-interest from Petitioner when the original partnership (Spiesman & Spiesman) was formed (T. 120, 121). The penciled changes made on the partnership agreement here involved reflect that.

The Government certainly cannot complain that the agreement couldn't be overcome by parol evidence since it has long been the rule that the parol evidence rule is inapplicable to tax litigation since the Government was not a party to the original agreement and therefore cannot complain. See *Haverty Realty & Investment Co.* (1944) 3 T.C. 161 at page 167.

The change in the partnership agreement only reflected what the record shows as to the true facts, i.e., that Petitioner, his father and minor children, entered into a partnership by contributing capital and equipment to the partnership (T. 69, 70, 83, 92).

The gifts which Petitioner's father made to the partnership were in line with an overall pattern of gift-making which had been undertaken many years earlier by the elderly man for the very valid purpose of reducing the costs of probate (T. 52). It must also be remembered that the original partnership, Spiesman & Spiesman, was never challenged nor has the validity of that partnership ever been at issue.

The partnership agreement contained no restrictions, such as is often the case in these family partnership arrangements, but provided in effect that the parties could withdraw the profits, after the indebtedness had been paid, periodically at either monthly or quarterly intervals. It is important to note that no restrictions in this regard were imposed upon the parties to this proceeding or to the other partners (Ex. 10, pg. 3).

The partnership operation was valid—the salary paid to Petitioner was reasonable—partnership returns were filed each year showing the proper distributive share of the partnership income to each individual partner involved. The record shows that tax returns were filed on behalf of the children, (T. 125) and it must be assumed in the absence of anything contrary that the returns reported the proper distributable share of partnership income since the Respondent did not introduce the individual income tax returns to overcome the testimony of the Petitioner.

The facts surrounding the partnership formation are not indicative of sham. The Tax Court erred in failing to consider any of the above factors or to comment upon certain material factors surrounding events *subsequent* to the taxable years. The subsequent facts, which were not mentioned, point directly to anything but a sham and lend credence to the validity of the gifts and to the partnership involved herein.

For example, the partnership is still in existence (T. 70, 91). The Idaho law held slot machines unconstitutional after December 31, 1953, (T. 181) but in January of 1955 each partner, including the Petitioner's five children, contributed an additional \$500 in capital to the partnership (T. 91, 92). The uncontroverted evidence clearly established the fact that as late as August of 1956 the bank account balances in the names of the minor children had not been disturbed. (See Exhibits J. K. L. M. N.) There was no activity in the partnership either by the Petitioner,

Petitioner's father, or the minor children involved herein which would in any way indicate that the transaction was a sham.

Yet the Tax Court on these facts found a sham transaction. The Tax Court does not, however, consider all of the material facts. The facts which the Tax Court did consider are rebuttable.

Congress, when the word "sham" was mentioned, couldn't have had a factual situation such as the instant one in mind when the Revenue Act of 1951 was enacted. If they did and if the Tax Court can arbitrarily find sham, without any evidence that the donor used the proceeds of the partnership for his own purposes, then the 1951 Revenue Act accomplished nothing. True, a sham would exist if the Petitioner had attempted to use the partnership funds allocable to his children for his own benefit in an effort to funnel low surtax money off to himself for his own use.

The Tax Court's finding of fact disposes of any such contention. The Tax Court finds as a fact that the money was used to pay premiums on the insurance policies held by the minor children; to pay income taxes for the minor children; to purchase additional securities for the minor children; or deposited in a separate savings account for each minor child in the Farmers and Merchants Bank of Rockford, Rockford, Washington (T. 174). No contention is made nor did the findings of fact reflect that the Petitioner appropriated any of the children's money for his own use. Nor was the money used for the support, main-

tenance, and education of the children (T. 174). This factor, we believe, is extremely important in the case.

The motive for forming the partnership is not the "touchstone" under the amendments made by the Internal Revenue Code of 1951, *supra*.

The Committee Reports, referred to above, mention but two instances where a partnership can be disregarded for tax purposes (1) where the donor retains all the incidents of ownership, i.e., the *Clifford* case (*Helvering v. Clifford*, 309 U. S. 331), and (2) where the gift is a *sham*. *Sham* is synonymous with false, it implies make believe, a feigned something, an imitation, a counterfeit. See *Words and Phrases*, Vol. 39 at page 197. When used by the Committee it had to mean a false partnership where the donor used the partnership proceeds to his own benefit. Any other meaning would render the Revenue Act of 1951 meaningless and the confusion that admittedly existed prior to the partnership changes in the Revenue Act of 1951 would be again running rampant leaving in its wake, confused taxpayers, expensive litigation and crowded court calendars.

The Tax Court, in its ultimate findings, in using the word *sham* without giving the reasons for so finding has done exactly what it has been forbidden to do by another Circuit Court of Appeals in *Benjamin D. Gilbert v. Commissioner*, (CA-2, 1957) 248 F. 2d 399, remanding T.C. Memo 1956-137. The Second Circuit Court of Appeals in commenting upon a Tax Court finding to the effect that advances were not bona fide debts said:

“The opinion of the Tax Court only states a conclusion without assigning the reasons therefor. . . . The opinion of the Tax Court does not state the ground upon which its decision rests.”

The facts here certainly leave little doubt that the children received the money and that Petitioner, his children and father operated a bona fide partnership that should be recognized for tax purposes.

ARGUMENT ON ASSIGNMENTS OF ERROR

Number II(a) to (d), Inclusive.

The Tax Court of the United States, in arriving at its ultimate finding that the partnership Spiesman & Sons was invalid for federal income tax purposes, based said finding upon certain factors which appear erroneous. The Tax Court in so finding failed to give consideration to all of the surrounding circumstance *prior, during, and subsequent* to the formation of the partnership. Some of the factors which the Tax Court relied upon are clearly immaterial and others it can be shown are more indicative of a finding that the partnership was valid rather than a finding that the partnership was a sham.

Argument on Assignment of Error II(a).

The Tax Court first commented upon the fact that the partnership agreement contained certain changes which were made subsequent to the formation of the partnership and upon the fact that the partnership agreement is inconclusive as to the ownership of the coin-operated machines, i.e., that the capital accounts of the minor children failed to show any interest in the machines (T. 182, 183).

As has been explained under assignment of error number I, the partnership agreement was changed to clearly reflect the intent of the parties. The parol evidence was clearly admissible, see *Haverty Realty and Investment Co.*, supra, and the Respondent has no evidence with which to controvert the clear intent of the parties. The Tax Court has perhaps best illustrated the unimportance of this point by stating "whether such assets were owned by one or both is immaterial insofar as the children are concerned" (T. 182, 183). The facts however show that the Petitioner's father owned half of the machines and that he gave a portion of his share to the children. The interlineations appearing on the partnership agreement (Ex. 10) fail to overcome the facts of record. As a matter of fact, the Tax Court in commenting upon the partnership agreement failed to point out that the agreement was duly executed and contained no limitations upon the right of the parties to withdraw their distributive share of partnership income. These factors are important to the decision in this case.

Argument on Assignment of Error II(b).

The Tax Court states that the facts do not support the contention that the children were the owners of a one-ninth interest in the machines because no written transfer of title to the machines was made and the partnership returns show the full value of the machines included in Petitioner's capital account and no interest in the machines included in the capital account of any of the children (T. 183).

The facts surrounding the transfer of title to the machines are clear. As pointed out above, there is no question that title to the machines prior to the transfer to the new partnership (Spiesman & Sons) was owned one-half by Petitioner's father (T. 81, 82). Petitioner's father had paid cash for an undivided half interest in the machines when the original partnership was formed and the money which Petitioner received for these machines was put in his personal account (T. 121). The uncontroverted testimony of Petitioner's father shows that he gave the children his interest in Spiesman & Sons by signing the partnership agreement (T. 74). The Plaintiff as guardian for the children accepted the gifts (T. 111). Wherein are the facts which support the Court's statement that the children didn't receive the one-ninth interest? The only reason could be the Tax Court's failure or refusal to recognize the testimony and there is no basis in the record for such assumption. Certainly the testimony of Petitioner and his father has not been impeached.

It would make no difference that there was no written evidence of transfer of title in the machines from Petitioner and his father to the minor children. The partnership agreement itself, however, is sufficient written evidence for this purpose since it must be admitted that the minor children had a one-ninth interest in the partnership and that the Petitioner's father testified he made the gifts by entering into the family partnership here at issue (T. 73, 74). This makes the ownership in the machines conclusive rather than inconclusive as the Tax Court found.

Apparently the Tax Court placed great weight on the fact that the partnership accounting as shown on the tax returns placed the full value of the machines in the capital account of the Petitioner. The only answer to this is that the returns and the accounting from which returns were prepared are wrong. The best evidence is the fact that Petitioner's father owned one-half of the machines and yet the whole value was erroneously shown on the taxpayer's account. This illustrates the fact that such treatment on the returns was clearly erroneous and must be an unfortunate accounting error. In any event, the cases illustrate the fallacy of placing too much emphasis on obvious accounting errors. They certainly couldn't be controlling. In *Sitterding v. Commissioner* (CA-4, 1936) 80 F. 2d 939 rev'g 32 B.T.A. 506, the Court said:

“Mere bookkeeping entries cannot preclude the Government from collecting its revenues, nor are such entries conclusive upon the taxpayer. The bookkeeping creates nothing, and the question must be decided according to proven and established facts.”

As applied here, the proven and established facts are that Petitioner and his father turned over a portion of their interest in the machines to the Petitioner's minor children. A finding of fact contrary to this, based on the erroneous inclusion of all the machines in the Petitioner's capital account on the partnership tax return, is erroneous. The mistake was immaterial and it had no bearing whatsoever on determining the ownership of the machines.

Argument on Assignment of Error II(c).

The Tax Court placed equal weight on the fact that the partnership returns and guardianship accounting showed the withdrawals to the children to be unequal. The partnership income tax returns (Ex's. 5-E, 6-F), however, show equal distributions of partnership income and there is no controversy that the children filed returns picking up this distributable share. The partnership income was equally divided. It makes no difference that unequal amounts were actually withdrawn. The important thing is that the income was distributed to the children equally on the return and that this is the amount, which under the law they would have to report. The clear testimony is that the returns were filed for each year on behalf of the children and the Government certainly failed to introduce anything that would contradict this fact. It is the distributive share of partnership income allocated to each partner which controls the income tax consequence not the amount withdrawn from the partnership. The other important point not mentioned by the Tax Court is the fact that when Petitioner found he was wrong in making unequal withdrawals, he evened up the withdrawals in later years (T. 90, 91).

The unequal withdrawels caused the Tax Court to say that Petitioner's actions in this regard were "the actions of a parent who owned, controlled and distributed his own funds according to his own desires" (T. 184). The greatest refutation of this is that the funds were never used by or for Petitioner. The Tax Court's finding best illustrates this. The money was

used solely for the children. Is this the action of a sham or of a parent who is using the money for his own uses? The Tax Court failed to note that the Probate Court approved the Guardianship Accounting and their finding also refutes the contention that the Petitioner as a parent of the five minor children controlled and distributed *his* own funds according to *his* own desires. The Probate Court disagrees with the Tax Court on this point (Ex. 14).

Argument on Assignment of Error II(d).

The Tax Court opinion concludes by citing *Commissioner v. Culbertson*, supra, and the oft-quoted language used therein (T. 185). Perhaps reference to the tests laid down in the *Culbertson* case is the best evidence that although the 1951 law as cited, supra, is controlling, the Tax Court of the United States in this regard does not recognize it in the instant case (T. 175). The senate committee reports dispose of any argument in the *Culbertson* case as follows:

“However, the frequency with which the Tax Court, since the *Culbertson* decision, has held invalid family partnerships based upon donations of capital would seem to indicate that, although the opinions often referred to ‘intention,’ ‘business purpose,’ ‘reality,’ and ‘control,’ they have in practical effect reached results which suggest that an intra family gift of a partnership interest, where the donee performs no substantial service, will not usually be the basis of a valid partnership for tax purposes. We are informed

that the settlement of many cases in the field is being held up by the reliance of the field officers of the Bureau of Internal Revenue upon some such theory. Whether or not the opinion of the Supreme Court in *Commissioner v. Tower* (327 US 280) and the opinion of the Supreme Court in *Commissioner v. Culbertson* (337 US 733), which attempts to explain the *Tower* decision affords any justification for the confusion is not material—the confusion exists.”

The *Culbertson* case was either overruled, or so limited by the changes made in partnership taxation by the Revenue Act of 1951, that it is ineffective as precedent in the instant case. The Committee reports, above, dispel any attempt to revert back to the *Culbertson* rationale. It is that era of confusion that gave birth to the Revenue Act of 1951.

The Tax Court in its opinion keeps eluding to the fact that all facts and circumstances must be considered as is indicated by the committee reports accompanying the 1951 Revenue Act (T. 184). Yet, as has been illustrated, there are a great many material facts in the record that haven't been touched upon or found material enough to enter their way into the Tax Court's finding of fact.

When all the factors “at the time of the purported gifts and during the periods preceding it and following it” are taken into consideration, the instant partnership is valid within the ambit of the Revenue Act of 1951.

ARGUMENT ON ASSIGNMENTS OF ERROR**Number III(a) to (c), Inclusive.**

The Tax Court of the United States referred in its opinion to three other factors which, though specifically slated to be non determinative (T. 182) in its ultimate finding, are of some importance and bear comment (T. 180-182). The Petitioner submits that the factors mentioned are actually, where properly construed, helpful to the Petitioner's assertion that the partnership involved herein was valid for federal income tax purposes. This argument will be illustrated below.

Argument on Assignment of Error III(a).

The Tax Court mentions the Government's argument that there was no accounting or supervision by the Probate Court during the taxable years here involved (T. 180).

It must be remembered here that Petitioner was the guardian of the four minor children having been so appointed in 1947 more than four years before the formation of the partnership and was appointed guardian of the youngest child, Francis Spiesman, in 1953 (Ex. 11, 12). The Tax Court here states: "We need not, and we do not, here determine whether the filing of a fiduciary of such accountings and reports as are required by state laws is a necessary condition to the recognition of a minor as a member of a partnership." However, although finding that the regulations, referred to by Respondent, which were promulgated in August of 1953 (Regs. 118, 39.191-1) weren't

applicable until after the taxable years involved herein, the court then went on to state that, "We have no doubt, however, that the filing or failure to file such accounting and reports may be considered, as a fact and circumstances following the purported gifts, in determining the bona fides or lack of bona fides of a purported gift or sale, and we have done so in our determination" (T. 180). If the filing or failure to file accounting reports may be considered or is to be considered, then the Tax Court erred in finding that the conduct of the Petitioner herein didn't substantiate the fact that the transaction was bona fide.

Petitioner it is true filed the inventory and accounting late—after the Internal Revenue Service started their investigation (T. 100). Prior to that time, however, Petitioner did not know that the accounting and inventory had to be filed. The Internal Revenue Agent told him it had to be done (T. 100). He wasn't advised by the attorney to do so and he did file on the advice of the Revenue Agent and probate judge (T. 114). Prior to this time, however, the record shows that Petitioner made a proper accounting of the money to himself. The money was used to buy stocks and bonds for the children in their names and Petitioner didn't put himself on the instruments as co-owner (T. 123). When the time did come for the accounting, everything was in order. The first inventory and accounting reflects in effect the action of Petitioner as guardian over the period 1947 to 1953 (Ex. 13).

The Tax Court states as follows:

“The proper accounting for a ward’s estate by a fiduciary is primarily a matter for the state court to determine.” (T. 180)

The Probate Court in and for Benewah County, Idaho, approved the Guardianship account and issued an order settling the same (Ex. 13).

The Tax Court says it is up to the State Court and the State Court says the accounting is entirely proper and yet the Tax Court uses this statement as one of the facts in holding the partnership invalid as being a sham. The inventory and accounting—though late—clearly reflect the complete bona fides of the Petitioner’s actions. The money was always used for the benefit of the children and this is the touchstone of reality. Should a few mistakes concerning the law made by a layman mitigate against an otherwise perfectly valid bona fide transaction? The children received all of the money and the State Probate Court recognized this fact. The Tax Court of the United States erred in not recognizing this fact as controlling in Petitioner’s favor.

Argument on Assignment of Error III(b).

The court next cites Idaho State Law (T. 163, 180, 181). It is here to be noted that the important fact that during the taxable years involved herein, 1951 and 1952, coin-operated devices were perfectly *legal* in the sovereign state of Idaho. The applicable sections were contained in Chapter 15, Title 50 of the

Idaho Code comprising Sections 15-1501 to 1510, inclusive. The Idaho Supreme Court in *State v. Village of Garden City*, (1953) 74 Idaho 513, 265 P. 2d 328, held that the statute laws of 1947, which enacted the sections mentioned above into law, were unconstitutional since the legislature could not by law circumvent the Idaho constitutional provision against lotteries. The legislature repealed Chapter 15, Title 50, above, in Chapter 62, Idaho Sessions Laws (House Bill No. 20). Such act in section 4 provides as follows:

“This act shall be in full force and effect on and after January 1, 1954.”

The act was approved February 23, 1953.

There can be no doubt that Petitioner herein was operating within the legislative law of Idaho during the taxable years involved in this proceeding.

The Tax Court cites Section 50-1504 of the Idaho law to the effect that no coin-operated amusement device might be operated on any premises except those owned or leased by the licensee, and, further, that no person other than the licensee “may have any legal, equitable, or financial, title or interest in such device, whether by ownership, mortgage, additional sales contract, or otherwise, nor receive any rent or remuneration therefrom or from the operation thereof” (T. 181). Petitioner in this regard testified that the machines were put on the premises of the Gem State Club under an operating agreement that he had with the Gem State Club prior to the formation of the first partnership, (Spiesman & Spiesman (T. 119). The

uncontroverted evidence shows that the policy was to place the license in the name of the location. This, as Petitioner testified, was required by the Internal Revenue Service (T. 115, 116). The law certainly substantiates Petitioner's statements in this regard.

Section 3267 of the Internal Revenue Code of 1939 entitled "Tax on Coin-Operated Amusement and Gaming Devices" provides in part as follows:

"Every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device shall pay a special tax as follows:"

It is clear from this that the federal tax is to be paid by the location for permitting the "use of coin-operated amusement devices on the premises." The Idaho State law had never been passed upon, decided nor has our research indicated that the question was ever presented.

The state law in federal tax matters has never been controlling either for or against the taxpayer or the government. This is true even where no conflict in the two laws appear. What the court said in *Burnet v. Harmel*, (1932) 287 U. S. 103 is indeed pertinent here:

"State law may control only when the operation of the federal taxing act, by express language or by necessary implication, makes its operation dependent upon the state law."

This principle is clearly recognized by the 9th Circuit Court of Appeals in the much quoted case of *U. S. v. Kintner*, (CA-9, 1954) 216 F. 2d 418, wherein it was said:

“The Government’s contention, based upon the proposition that because, under local law, a corporation is not allowed to practice medicine, the group is not an association, would introduce an element of uncertainty which neither the courts nor the regulations have recognized. Groups which could not engage in certain activities under State law because of their particular structure, or were considered partnerships have been recognized as legitimate ‘associations’ partaking of corporate character for taxing purposes under federal law.

“It should be added that it would introduce an anarchic element in the federal taxation if we determined the nature of associations by State criteria rather than by special criteria sanctioned by the tax law, the regulations and the courts. It would destroy the uniformity so essential to a federal tax system—a uniformity which calls for equal treatment of taxpayers, no matter in what State their activities are carried on. For it would mean that tax incidences as to taxpayers in the same category would be determined differently according to the law of the State of residence.”

In summary, the Idaho State Law, referred to above, is in direct conflict with the federal law, so for federal income tax purposes federal law must control. In any event, State law is not determinative on the

question of the validity of a family partnership since State law does not control for federal income tax purposes.

Argument on Assignment of Error III(c).

The Tax Court of the United States in holding that the partnership Spiesman & Sons was invalid, cites as authority its previous decision in *E. C. Ellery*, (1944) 4 T. C. 407. The taxpayer in the *Ellery* case was the owner and operator of slot machines which were *illegal* under the laws of the State of Ohio. In 1939, the taxpayer had pled guilty to an income tax evasion charge and, before he served his sentence, decided to make his wife a partner so that she could run the business while he was away. The Tax Court held that the partnership was invalid and in so holding stated as follows:

“Since the gift was conditioned on the formation of the partnership and the partnership could not be formed in Ohio because of its illegal purpose, the gift failed at the outset. The gift failed ‘because’ it (was) expressly or by implication * * * made upon a condition or limited to a purpose, which it failed.”

But the Tax Court in the *Ellery* case didn’t decide the case on this point. They then went on to say:

“We have not found it necessary to place this decision squarely on the grounds urged by Respondent that a partnership void by state law because of illegality should not be recognized for tax purposes any more than it is otherwise recognized by the Courts.”

The Tax Court thereupon concluded as follows:

“This is not to deny that there are instances where there is no other feasible solution than to recognize as a partnership for tax purposes that which would otherwise not be so recognized, whether it be because of illegality of the business or incompetence of the parties.”

In *Hanson v. Birmingham*, (District Court, Northern Division of Iowa 1950) 92 F. Supp. 33, it was held that a trust could not be a valid partner for federal income tax purposes. The court in so deciding commented at length upon the question of whether a partnership invalid under state law could nonetheless be a valid partner under the federal tax statutes. After citing cases pro and con, the court said:

“It is not clear from the authorities as to what the rule is wherein a partnership is invalid or not recognized under the local law.”

The *Ellery* case is cited therein.

Strangely, the Tax Court itself in *Theodore D. Stern*, (1950) 15 TC 521 apparently distinguished the *Ellery* case when it said:

“A married woman cannot be a partner under the law of some states and yet she would be recognized as a partner with her husband under the above definition for federal income tax purposes if, for example, they conducted a woman’s hat shop in which the wife was even more important and the husband had a ‘partnership agreement’ under which her interest was 60 per cent. A

trust's distributive share of the net income of a partnership would have to be included in its gross income in many cases, if for no other reason than that there would be no one else to which the income could be lawfully taxed. Cf. *E. C. Ellery*, 4 T.C. 407, 413. The *Fickert* case, *supra*, is one example, and others can easily be imagined, including a case where trust corpus was used to buy a building to be managed by another under a so-called partnership agreement in which the manager was to receive a salary and a portion of the profits and the trust was to receive interest on its contribution and a share of the profits. If not a partnership under state law, it may still be a joint venture and thus a partnership for present purposes. Thus, even if a trust could not be a partnership under common law, and even though the enlarged definition of a partnership now appearing in Section 3797 may not have been for the express purpose of covering such a situation, nevertheless, it should be used and it has been used for that purpose."

Under the authority cited by the Tax Court (the *Ellery* case), the partnership could be valid for federal tax purposes though not valid for state purposes. Unquestionably, this would have to be the case. However, the big feature that distinguishes the instant partnership case from the cases cited above, and apparently relied upon in part by the Tax Court, is the fact that when the gifts were made here in the instant case and when the partnership was formed and during the operation of the partnership for the taxable years involved herein, the legislature of the State of

Idaho completely sanctioned the use of coin-operated machines. Here is a situation where the Tax Court would have a partnership fail because the State law under which the partnership operated was subsequently held unconstitutional.

The instant case is a factual case involving a family partnership under the 1951 changes made by Congress in the law regarding partnerships and the first time that the Tax Court has had an opportunity to look at the 1951 changes and the act clarifying the whole partnership picture. Under the new law, the Tax Court, in its findings of fact, had to find either that the Petitioner retained dominion and control under the *Clifford* rationale or that the partnership was a complete *sham*.

In looking over the record, the Tax Court must look at events both *before*, *during* and *subsequent* to the formation of the partnership. The record does not support a finding of sham since in all instances the transactions were in accordance with clearly defined and established partnership principles.

The *Clifford* rationale could certainly not be controlling since the gifts were completed and the amounts allocated to each child have been religiously preserved for their benefit by the Petitioner herein. The facts just do not support the ultimate finding that the partnership Spiesman & Sons was invalid so far as the five minor children of the Petitioner are concerned.

ARGUMENT ON ASSIGNMENT OF ERROR IV.

Petitioner in his opening statement referred to the fact that the Internal Revenue Service was taxing the entire income of his children back to Petitioner. Petitioner's then counsel stated:

“One important point, I think, that is very obvious here is that the income the children received was taxed for the year or for the period beginning after December 1, 1951, through 1952, to the father instead of any of it being taxed back to the grandfather, Mr. M. J. Spiesman, Sr.” (T. 37)

The Internal Revenue Service in its 90-day letter which advises of the deficiency and the reasons for it, stated as follows:

“... and the earnings of the business, Spiesman & Sons, are primarily attributable to the service of Mathew J. Spiesman, Jr., and your capital contributions, and further, that to no substantial extent are such earnings attributable to either capital or services of any of the said minor children.” (T. 20)

No mention was made in the statutory notice of deficiency of the fact that the original gifts were made by the Petitioner and Petitioner's father.

The undisputed facts, however, are quite clear. The original partnership was between Petitioner and Petitioner's father (Ex. 9). Petitioner's father contributed one-half of the assets of the then partnership

and received a return of one-third of the income (T. 110). This partnership interest and/or the assets owned by the partnership were the subject of the gifts to the children herein. The uncontroverted evidence shows that Petitioner's father made such gifts (T. 74, 87). This has never been controverted nor has any evidence been introduced by the Internal Revenue Service which would indicate that the original partnership between Petitioner and his father was invalid.

Petitioner takes the position herein that the family partnership is valid, but assuming for the sake of argument that it isn't, the problem still remains as to the validity of the action of the Internal Revenue Service and the Tax Court in failing to recognize that Petitioner can be taxed only on the amount of income which was generated by the gifts which Petitioner had given to the children. Taxing Petitioner on income earned by the children on property given them by another is carrying the family partnership disallowance doctrine a step further than it has ever been carried before.

The Government certainly introduced no evidence to controvert the fact that Petitioner and his father had a valid partnership. The Court didn't comment on Petitioner's argument in the opening statement. The facts support no other conclusion than the validity of the original partnership and the Petitioner submits that regardless of the outcome of this appeal, the amounts taxable to Petitioner must be decreased by the amount allocable to the gifts made by the grandfather to the children.

CONCLUSION

In deciding the instant case adversely to the Petitioner, herein, the Tax Court of the United States failed to recognize the import of the Revenue Act of 1951. In addition the Tax Court failed to give full consideration to the facts of record both *befor*, *during* and *subsequent* to the formation of the partnership. The facts of record—when they are all considered—support the Petitioner's contention herein that the partnership Spiesman & Sons was valid for federal income tax purposes.

Respectfully submitted,

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In the United States Court of Appeals
for the Ninth Circuit

MATHEW J. SPIESMAN, JR., and MARY SPIESMAN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the
Tax Court of the United States

BRIEF FOR THE RESPONDENT

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 15752

**MATHEW J. SPIESMAN, JR., and MARY SPIESMAN,
PETITIONERS**

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**On Petition for Review of the Decision of the
Tax Court of the United States**

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 161-186) are reported at 28 T.C. 567.

JURISDICTION

The Commissioner determined that there were deficiencies in the income taxes of Mathew J. Spiesman, Jr., and Mary Spiesman for the years 1951 and 1952 as follows (R. 161) :

<u>Year</u>	<u>Deficiency</u>	<u>Additions to Tax ¹</u>
1951	\$ 2,155.22	\$356.93
1952	14,056.20	986.14

A notice of such deficiencies was mailed on November 18, 1954. (R. 16-24.) Taxpayers filed a petition for redetermination of these deficiencies in the Tax Court on January 28, 1955, within the permitted 90-day period under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 5-16.) On June 7, 1957, the Tax Court entered a decision that there were deficiencies in income tax in the amounts of \$2,155.22 and \$14,056.20 for the years 1951 and 1952, respectively. (R. 186.) On August 29, 1957, the Tax Court entered an order amending its decision providing that there were no additions to tax for the years involved. (R. 187.) The case is brought to this Court by a petition for review filed on August 30, 1957. (R. 188-192.) The jurisdiction of this Court is invoked under the provisions of Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court correctly held that the taxpayers' five minor children were not the real owners of capital interests in the taxpayers' business and were not bona fide partners in the Spiesman & Sons partnership during the years 1951 and 1952.

¹ No issue is presented in this appeal concerning the additions to tax. The Commissioner abandoned his determination that taxpayers were liable for such additions during the proceedings in the Tax Court. (See R. 185.)

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 191 [As added by Sec. 340(b) of the Revenue Act of 1951, c. 521, 65 Stat. 452].
FAMILY PARTNERSHIPS.

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purpose of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons.

(26 U.S.C. 1952 ed., Sec. 191.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * *

(2) [as amended by Sec 340(a) of the Revenue Act of 1951, *supra*] *Partnership and Partner*.—The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in such a syndicate, group, pool, joint venture, or organization. A person shall be recognized as a partner for income purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

* * * *

(26 U.S.C. 1952 ed., Sec. 3797.)

STATEMENT

The facts as found by the Tax Court (R. 162-174) may be summarized as follows:

Taxpayers Mathew J. Spiesman, Jr. and Mary Spiesman, are husband and wife residing at St. Maries, Idaho. They filed a joint federal income tax return for the calendar year 1951 with the then Collector of Internal Revenue for the District of Idaho, and for the calendar year 1952, with the District Director of Internal Revenue, Boise, Idaho. (R. 162.)

Prior to 1950, taxpayer Mathew J. Spiesman, Jr.

(hereinafter sometimes referred to as Spiesman or as the taxpayer), was the owner of certain gambling devices commonly known as slot machines. These machines were operated in a bar known as the Gem State Club under an agreement between Spiesman and the Club, whereby Spiesman received 20 per cent of the receipts from the slot machines. Spiesman was president and manager of the Gem State Club, a corporation. In 1947 the legislature for the State of Idaho enacted a statute (S.L. 1947, c. 151; Sections 50-1501 to 1510, inclusive, Idaho Code), which was subsequently declared unconstitutional and repealed, providing that it should be lawful for any person to own and operate coin-operated amusement devices within the corporate limits of any incorporated city or village, after having first procured a license as therein provided. The term "person" was defined to include "an individual person, partnership, corporation or association". (R. 162-163.)

On February 1, 1950, Spiesman, Jr., and his father, Mathew J. Spiesman, Sr., entered into a partnership agreement for the purpose of carrying on the business of operating and maintaining coin-operated amusement devices. The agreement recited that "the assets to be taken over by the partnership are in the possession and owned by the partner, M. J. Spiesman, Jr." It further recited that "M. J. Spiesman, Sr., agrees to pay a sum equal to one-half the value of the assets;" that they should bear "equally between them all licenses, fees, permits and other expenses" required for the support and management of the business; and that profits from the business

should be divided, one-third to Spiesman, Sr., and two-thirds to Spiesman, Jr. (R. 163-164.)

Spiesman, Sr., now 80 years of age, had for several years been distributing part of his estate by making gifts of real estate, stocks and mortgages to Spiesman, Jr., and to the latter's five sons, whose names and date of birth are as follows (R. 164):

<u>Name</u>	<u>Date of Birth</u>
Michael Joseph.....	October 21, 1940
Philip James.....	November 29, 1943
Leonard John.....	February 11, 1945
Mathew James III.....	July 3, 1946
Francis Edward.....	September 26, 1950

On December 1, 1951, a new partnership agreement was entered into between Spiesman, Sr., and Spiesman, Jr., individually and on behalf of his five minor sons (R. 164), which is in part as follows (R. 164-170):

Partnership Agreement

This Agreement of Partnership, made in duplicate as of the first day of December, 1951, by and between Mathew James Spiesman, Sr., Mathew James Spiesman, Jr., Michael James [Joseph] Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, and Francis Edward Spiesman, all of St. Maries, Benewah County, Idaho,

Witnesseth, that the said parties have agreed and by these presents do agree to associate themselves as partners for the purpose of carrying on the business of operation and maintenance of coin-operated amusement devices, and incidental concessions connected therewith, to the

faithful performance of which they mutually bind and engage themselves, each to the other, their executors and administrators.

First: The name, style and title of such partnership shall be Spiesman & Sons,

Second: At the time of this agreement, the assets to be taken over by the partnership are in possession and owned by the partner[s], Mathew James Spiesman, Jr., [and Mathew J. Spiesman, Sr.] and are in the value of \$2,374.63. The capital of said partnership in addition to the aforementioned assets shall consist of cash contributions divided into nine equal shares, of which each of the partners shall own one-ninth, with the exception of the partner, Mathew James Spiesman, Jr., who shall own one-third of the shares. Further cash contributions shall consist of:

Michael James Spiesman.....	\$100.00
Mathew James Spiesman, III.....	100.00
Philip James Spiesman.....	100.00
Leonard John Spiesman.....	100.00
Francis Edward Spiesman.....	100.00

The capital of the partnership in addition to the initial cash contributions enumerated above shall also consist of the income and profits arising from the employment thereof, with the exception of that which each is entitled to withdraw as hereinafter provided. That said capital may at any time be reduced or extended by agreement between the parties hereto, and that the said capital, together with all credits, goods, wares or commodities bought or obtained by the said firm, by barter or otherwise, shall be kept, used and employed in and about the business aforesaid.

Third: The term for which this partnership is organized is for an indefinite period from and after December 1, 1951.

Fourth: Duties of Partners. The partner, Mathew James Spiesman, Jr., shall be actively in charge of the business and shall assume the functions customarily performed and shall perform the duties as manager. He shall devote a major portion of his time, attention, experience and endeavors to said business. The partners, Mathew James Spiesman, Sr., Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman and Francis Edward Spiesman, shall and will at all times during the continuance of the partnership bear, pay and discharge equally with all partners all the licenses, fees, permits and other expenses that may be required for the support and maintenance of said business.

* * * *

Seventh: Share in Profits. Periodically, at either monthly or quarterly intervals, each partner shall be entitled to withdraw from the business as a salary an amount of income commensurate with the capital stock owned by them and the services which they have contributed; however, under no circumstances shall said withdrawals impair the operating capital of the partnership. No further withdrawals shall be made in the form of profit after payment of salaries to the partners until such time as all indebtedness owing by the partnership has been paid.

In addition to the above-mentioned share in the profits, the partner, Mathew James Spiesman, Jr., shall draw as salary for managing the

partnership business the sum of Two Hundred Fifty (\$250) Dollars per month.

* * * *

In Witness Whereof, the parties hereto have hereunto set their hands and seals the day and year in this partnership agreement first above written.

/s/ MATHEW JAMES SPIESMAN,
 /s/ MATHEW JAMES SPIESMAN, JR.,
 /s/ MICHAEL JOSEPH SPIESMAN,
 /s/ MATHEW JAMES SPIESMAN, III,
 /s/ PHILIP JAMES SPIESMAN,
 /s/ LEONARD JOHN SPIESMAN,
 /s/ FRANCIS EDW. SPIESMAN,

By /s/ M. J. SPIESMAN, JR.,

Guardian for Michael James Spiesman, Mathew James Spiesman, III, Philip James Spiesman, Leonard John Spiesman, Francis Edward Spiesman.

The interlineations appearing in paragraph numbered "Second" were inserted by Spiesman, Jr., in 1953, after the initiation of the investigation of taxpayers' income tax returns for the year involved. The \$100 cash contributions on behalf of each of the minor children were made by their father either from funds belonging to them or advanced by him. (R. 170.)

A partnership return (Form 1065) was filed by Spiesman & Sons for the period beginning December 1, 1951, and ending January 1, 1952, showing

net earnings in the amount of \$3,254.30, distributable as follows (R. 170) :

Mathew J. Spiesman, I.....	\$ 361.59
Mathew J. Spiesman, II.....	1,084.76
Mathew J. Spiesman, III.....	361.59
Philip Spiesman	361.59
Michael Joe Spiesman.....	361.59
Francis Spiesman	361.59
Leonard Spiesman	361.59

No withdrawals for this period were shown and the capital accounts at the beginning of the period and at the end of the period were shown as follows (R. 171) :

	<u>Beginning of Period</u>	<u>End of Period</u>
Mathew J. Spiesman, I.....	\$ 100.00	\$ 461.59
Mathew J. Spiesman, II.....	2,774.63	3,859.39
Mathew J. Spiesman, III.....	100.00	461.59
Philip Spiesman	100.00	461.59
Michael Joe Spiesman.....	100.00	461.59
Francis Spiesman	100.00	461.59
Leonard Spiesman	100.00	461.59

A partnership return (Form 1065) was filed by Spiesman & Sons for the year 1952 showing net earnings in the amount of \$46,021.71, distributable as follows (R. 171) :

Mathew J. Spiesman, I.....	\$ 4,846.85
Mathew J. Spiesman, II.....	16,940.61
Mathew J. Spiesman, III.....	4,846.85
Philip Spiesman	4,846.85
Michael Joe Spiesman.....	4,846.85
Francis Spiesman	4,846.85
Leonard Spiesman	4,846.85

The capital accounts of each of the above-named partners at the beginning of the year 1952, with-

drawals during that year and the capital accounts at the end of the year were shown as follows (R. 172-172):

	Capital Account at Beginning of Year	Withdrawals	Capital Account at End of Year
Mathew J. Spiesman, I.....	\$ 461.59	\$ 3,688.83	\$1,619.61
Mathew J. Spiesman, II.....	3,859.39	16,768.68	4,031.32
Mathew J. Spiesman, III.....	461.59	4,690.16	618.28
Philip Spiesman	461.59	2,592.80	2,715.64
Michael Joe Spiesman.....	461.59	2,593.25	2,715.19
Francis Spiesman	461.59	3,448.01	1,860.43
Leonard Spiesman	461.59	4,950.96	357.48

The income shown on the partnership returns was derived from the operation of the slot machines and other coin-operated amusement devices, most of which were located in the Gem State Club and continued to be operated under the original agreement as to percentages entered into between Spiesman and the Club prior to the formation of the partnerships between Spiesman and his father, and Spiesman & Sons. All licenses for the operation of the machines were obtained and paid for by the Gem State Club or other locations where they were placed. Spiesman spent about 3½ hours each day in the management of Spiesman & Sons' affairs. He was also manager of the Gem State Club, for which he received a salary of \$6,000 in 1951 and \$7,500 in 1952, and spent six to seven hours each day in its management. Capital is a material income-producing factor of the Spiesman & Sons partnership. The salary paid Spiesman for managing the affairs of the partnership is reasonable. (R. 172.)

Spiesman had been appointed guardian of the estates of his four minor sons, Michael Joseph, Philip James, Leonard John, and Mathew James, III, by the Probate Court of Benewah County, Idaho, on April 17, 1947. He was appointed guardian of the estate of Francis Edward by the same court on October 13, 1953. (R. 172-173.)

No opening or annual inventory and accounting reports of the estates of any of the minor children, as required by Sections 15-1825 and 15-1826 of the Idaho Code (1948), were filed by Spiesman as guardian during any of the years 1947 to 1952, inclusive; nor was there any supervision of the guardianship accounts otherwise exercised by the probate court during that period. On October 23, 1953, after the initiation of the investigation of taxpayers' income tax returns for the years involved, Spiesman as guardian filed annual inventory and accounting reports of the estates of four of his sons, Mathew James, III, Philip James, Michael Joseph and Leonard John, for each of the years 1947 to 1952, inclusive. These reports were approved, allowed and settled by order of the Probate Court dated November 12, 1953. As he had not, prior to October 13, 1953, been appointed guardian of Francis Edward, no inventory or accounting report of the estate of Francis Edward was filed at that time. Annual inventory and accounting reports of the estates of all five of the children for the years 1953, 1954, and 1955 were filed in 1954, 1955, and 1956, respectively. (R. 173.)

Withdrawals from the Spiesman & Sons partnership on behalf of each of the five minor children,

during the year 1952, were made by Spiesman. (R. 173.) According to the inventory and accounting reports filed by Spiesman as guardian of the estates of his minor children, the following amounts were withdrawn from Spiesman & Sons on their behalf, respectively, during the years 1952 to 1955, inclusive (173-174):

	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u>
Mathew James	\$5,690.16	\$3,124.20	\$ 270.73	None
Philip James	1,592.80	3,557.13	2,005.33	None
Michael Joseph	1,593.25	3,626.12	1,936.62	None
Francis Edward --- (not shown)		3,079.35	291.94	None
Leonard John	3,848.01	3,500.16	269.85	None

Separate savings accounts for each of the minor children were opened in the Farmers & Merchants Bank of Rockford, Rockford, Washington, on March 17, 1952. Some of the funds withdrawn from the partnership on behalf of the children were deposited in their respective savings accounts; some were used to pay premiums on their individual life insurance policies; some were used to pay their income taxes; and occasionally some were used to purchase additional securities for them. None of these funds, insofar as the accounting reports filed with the Probate Court reveal, were used for the support or living expenses of any of the minor children. (R. 174.)

On their income tax return for 1952, taxpayers reported the sum of \$17,077.25 as partnership income, of which \$16,940.61 was received from Spiesman & Sons, and \$136.64 from Spiesman and Resor. (R. 174.)

The Tax Court in a unanimous opinion held that

the five minor children of taxpayers were not the owners of capital interests in the business and were not bona fide partners in the Spiesman & Sons partnership during the years 1951 and 1952. (R. 174.)

SUMMARY OF ARGUMENT

1. The Tax Court correctly held that the taxpayer's children were not the real owners of capital interests in the taxpayer's business and were not bona fide partners with him during the years 1951 and 1952. The amendments to the Internal Revenue Code of 1939, insofar as they affected the law relating to the tax consequences of family partnerships, were intended to change the existing law in only one respect. Congress, in the Revenue Act of 1951 attempted to make it plain that a family partnership should not be denied recognition for tax purposes merely because some of the partners received capital interests in the partnership by gift. The intent of Congress is clear, however, that such intra-family arrangements should be carefully examined to see whether bona fide gifts were, in fact, made and whether the purported partnership was merely a sham. Congress did not intend that every purported family partnership should be recognized for tax purposes, merely because such a partnership is claimed to exist. Its only purpose in the 1951 amendments was to eliminate some existing confusion as to whether a valid partnership *could* be created by a true gift.

2. The Tax Court correctly applied the 1951 amendments to the facts in the instant case. The Tax Court did not hold that a valid partnership was

not created because the claimed capital interests of the taxpayer's minor children came into being through gifts. On the contrary, the Tax Court recognized that a valid partnership could be created by true gifts of capital interests, but found, on the record in the instant case, that no bona fide gifts were intended or made and that the purported partnership was a sham.

3. These factual determinations of the Tax Court are fully supported by the record in the case at bar and, accordingly, should not be disturbed on appeal. Several factors in the record point to the conclusion that no bona fide gifts were made and that the purported partnership was a mere sham devised for tax purposes. For example, the agreement which allegedly created the claimed partnership was not carried out in the extremely important matter of distribution of business profits. Distributions were not made to taxpayer's children in proportion to the capital interests which it is claimed they owned; instead, distributions were made by the taxpayer to equalize family gifts to the children. In addition, the failure of the taxpayer to file any guardianship accounts until after the tax investigation was begun also points to a lack of bona fides. Moreover, the taxpayer's children could not, under Idaho law, legally have owned interests in the slot machine which were the partnership assets. These and other facts affirm the correctness of the Tax Court's conclusion that no true gifts of business assets were made to the taxpayer's children, that the children were not true partners in the business, and that no partnership, valid

for tax purposes, was in existence during the years 1951 and 1952. Accordingly, the decision of the Tax Court should be affirmed.

ARGUMENT

The Tax Court Correctly Held That the Taxpayer's Children Were Not the Real Owners of Capital Interests In the Taxpayer's Business and Were Not Bona Fide Partners With Him During the Years 1951 and 1952

This case involves the validity of a so-called family partnership for the years 1951² and 1952. The Commissioner of Internal Revenue determined that the minor children of taxpayer Mathew J. Spiesman, Jr.,³ were not partners in the partnership called Spiesman & Sons within the meaning of Sections 191 and 3797 (a) (2) of the Internal Revenue Code of 1939, *supra*. The Tax Court, in an opinion reviewed by the entire court, without dissent upheld the Commissioner's determination. The taxpayer has appealed from the Tax Court's decision contending mainly that the Tax Court's construction of Sections 191 and 3797 (a) (2), as amended by Section 340 of the Revenue Act of 1951, was improper and that the evidence in the case does not support the Tax Court's findings. We submit, on the contrary, that the Tax Court's decision is in all respects correct and should be affirmed.

² The alleged partnership was in existence for only one month during the year 1951. (R. 170.)

³ Mary Spiesman is the wife of Mathew, Jr., and is a party because she and her husband filed joint income tax returns for the years involved. (R. 162.)

1. Prior to the Revenue Act of 1951, there existed some confusion as to whether a partnership valid for tax purposes could be created as the result of a transfer by gift of an interest in the business which became the subject of the partnership. The test for determining whether a valid partnership for tax purposes was in existence was laid down by the Supreme Court in *Commissioner v. Culbertson*, 337 U. S. 733. The question to be decided in such cases, according to the Supreme Court (p. 742), was one of fact and depended on "whether, considering all the facts * * * the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise". The Tax Court had been treating as essential to membership in a valid family partnership a contribution of either vital services or original capital. The Supreme Court pointed out (p. 741) that the Tax Court approach in such cases was "at best, an error in emphasis" and took pains to add (p. 745) that in an earlier decision (*Commissioner v. Tower*, 327 U.S. 280) it "did *not* say that the donee of an intra-family gift could *never* become a partner through investment of the capital in the family partnership" (italics supplied). The Supreme Court in *Culbertson* further pointed out (p. 746) that the "existence of a family relationship * * * is simply a warning that things may not be what they seem" and accordingly that "transactions between members of a family will be carefully scrutinized" to determine whether a donee of property who purportedly invests that property in a family partnership acquires sufficient dominion and

control over that property to influence the conduct of the partnership and the disposition of its income and thus becomes (p. 747) "a true partner".

Notwithstanding the Supreme Court's decision in the *Culbertson* case, there apparently still remained some confusion as to the creation of a family partnership through the use of gift capital. Therefore, in the Revenue Act of 1951, Congress added to the 1939 Code Section 191 which provides that—

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. * * *

Congress at the same time also added to Section 3797 (a)(2) of the 1939 Code, which defines the words "partnership" and "partner", a sentence providing—

A person shall be recognized as a partner for income purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

The intent of the Congress in adding these provisions to the Code is plainly expressed in the Report of the Committee on Ways and Means of the House

of Representatives. This Report, in part, is as follows (H. Rep. No. 586, 82d Cong., 1st Sess, pp. 32-34 (1951-2 Cum. Bull. 357, 380-381)):

Section 312 of your committee's bill is intended to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. Your committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.

Although there is no basis under existing statutes for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property. Many court decisions since the decision of the Supreme Court in *Commissioner v. Culbertson* (337 U. S. 733) have held invalid for tax purposes family partnerships which arose by virtue of a gift of a partnership interest from one member of a family to another, where the donee performed

no vital services for the partnership. Some of these cases apparently proceed upon the theory that a partnership cannot be valid for tax purposes unless the intrafamily gift of capital is motivated by a desire to benefit the partnership business. Others seem to assume that a gift of a partnership interest is not complete because the donor contemplates the continued participation in the business of the donated capital. However, the frequency with which the Tax Court, since the Culbertson decision, has held invalid family partnerships based upon donations of capital, would seem to indicate that, although the opinions often refer to "intention," "business purpose," "reality," and "control," they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. * * *

The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of Helvering v. Clifford (309 U.S. 351). The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between

family members. *Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny.* All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

* * * *

Since legislation is now necessary to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer, it is considered appropriate at the same time to provide specific safeguards—whether or not such safeguards may be inherent in the general rule—against the use of the partnership device to accomplish the deflection of income from the real owner. (*Italics supplied.*)

It is clear, then, that Congress was merely attempting to insure that a person would not be denied recognition as a member of a family partnership merely because he acquired his interest by a gift from a member of his family, *if, in fact, a real bona fide gift was intended and made.* It is clear, too, that the Congress intended that the courts carefully examine such intra-family gifts to determine *whether a bona fide gift was made, whether the transaction was merely a sham entered into for tax purposes and whether the donor had in fact relinquished dominion and control over*

the interest purportedly transferred. As the Committee Report states—

All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.

Thus, Congress merely was attempting to eliminate from consideration in such cases the one factor that the family partner's purported interest arose through gift if in fact a bona fide gift, was made, and to leave intact the other tests for determining whether a true partnerships existed. Cf. *Commissioner v. Culbertson, supra*, p. 742. As we shall show, the Tax Court in considering the instant case gave full effect to these 1951 additions to the Code and, taking into account the expressed intention of Congress, reached a result which is entirely permissible under the Code and one which is clearly supported by the record in the case presented.

2. That the Tax Court gave full consideration to the Code changes made by Congress in the Revenue Act of 1951, as they affected family partnership cases, is evident, we submit, from a reading of its opinion. In great length, the Tax Court examined the 1951 amendments and the accompanying legislative history in order to insure a correct application of the law to the facts presented in the instant case. And, in so doing, the Tax Court recognized that the fundamental principle which Congress intended to establish by the 1951 amendments was that (R. 176)—

where there is a *real* transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which activated the transfer * * *. (Italics supplied.)

Thus, the Tax Court properly addressed itself to the question of whether the evidence established "a real transfer of ownership" or whether the "partnership device" was used merely "to accomplish the deflection of income from the real owner". (R. 176-177.)

The Tax Court did *not* hold that merely because there was a purported gift transfer of partnership interests the children of taxpayer were to be denied recognition as partners. Rather, the Tax Court, as Congress intended, examined the evidence and found "that there were no bona fide gifts of interests in the machines, which were the income-producing assets of the partnership, to the children, and the formation of the Spiesman & Sons partnership was a sham". (R. 182.) Certainly, absent bona fide, or real, gifts of partnership assets, the minor children of the taxpayer could not be considered as being real partners. It is undisputed that they contributed no services whatever to the business. As we have shown, it was not the Congressional purpose that the so-called *Culbertson* test be ignored in family partnership cases, but that Congress merely intended to make clear that the transfer of a partnership interest by gift should not *in itself* invalidate a claimed partnership, if there had, in fact, been a real gift. Thus, in approaching the case first from the point of view of determining whether there were in fact real transfers of interests

in partnership income-producing assets to the taxpayer's minor children and then, after finding that not such transfers had been shown by the evidence, applying the *Culbertson* test, the Tax Court properly exercised the functions and prerogatives granted to it by Congress.

3. Whether bona fide gifts of partnership assets were made to taxpayer's children and whether the parties in good faith intended to join together in the present conduct of a business enterprise are questions of fact which, of course, must be decided in the light of the record in the case. *Commissioner v. Culbertson*, *supra*, p. 742. The Tax Court, the trier of fact, found that no bona fide gifts were intended or made and that the taxpayer's children were not bona fide partners in the business during the years 1951 and 1952. Under well-settled principles, such factual determinations may not be disturbed on appeal, unless they are found to be "clearly erroneous". Cf. *Smith v. Westover*, 237 F. 2d 201, 203 (C.A. 9th); *Parker v. Westover*, 248 F. 2d 490 (C.A. 9th). We submit that the findings of the Tax Court are not only not clearly erroneous but, moreover, are fully supported by the facts of record and, accordingly, the Tax Court's decision should be affirmed by this Court.

Several factors point to the correctness of the Tax Court's findings. First, the partnership agreement, which purportedly transferred ownership of a portion of the partnership assets to the children, was not carried out in the extremely important respect of distribution of profits. As the Tax Court noted (R. 183), although the children purportedly had equal

shares in the business, they did not receive equal treatment with respect to withdrawals from the business. During the years 1952, 1953 and 1954, the amounts withdrawn for the children were in some instances greater, and in other instances less, than they would have been had the agreement been followed. The explanation offered by taxpayer for this significant departure from the agreement was that (R. 90)—

the difference in the amount of money withdrawn was due to the fact that Joe, the oldest boy, and Phil, the next oldest boy, had income from dividend stocks prior to the, and more stock, than the other children, and I tried to even up—at that time I tried to even up the cash account of each child, so that if I had an accident, why, or I got killed or died, my youngest child wouldn't say, "Well, my dad wasn't very fond of me; he didn't leave me anything," and I didn't want to have that happen and I wanted them to be even as far as cash was concerned, and then they would eventually receive stock or whatever my dad was going to leave them when he died. But the cash account I tried to even up. It may have been wrong, but at that time I didn't know it.

This, we submit, clearly shows that there was, in fact, no real partnership in which the taxpayer's children were members. On the other hand, this does indicate that what transpired was merely the attempt of a father to provide for his children. As this Court has noted, the law does not require the sanctioning of an obvious device on the part of a taxpayer to build an estate for his children at the ex-

pense of the United States. *Smith v. Westover*, 237 F. 2d 201, 203 (C. A. 9th). If, in fact, real gifts of business assets had been made, there could be no reason why each child would not be entitled to the share of the income produced by his assets. Instead, this indicates that no gifts of the assets were, in fact, made and no partnership in any real sense was created.

Similarly, the taxpayer's failure to file any accountings as guardian, until after investigation was initiated by the Internal Revenue Service into partnership affairs, is also an indication that no valid partnership was intended or created. (See R. 100-101.) In addition, the inconclusive nature of the partnership agreement as an instrument of conveyance also is indicative of the fact that no bona fide gifts were made. No claim is made that there was any instrument of conveyance other than the partnership agreement and that document, itself, does not pretend to be such an instrument. Furthermore, as the Tax Court noted (R. 183) the "partnership" did not itself treat the taxpayer's children as having any interest in partnership assets; the partnership returns filed for the period December 1, 1951 to January 1, 1952, and for the year 1952 included the full value of the slot machines (the income-producing assets) in the capital account of the taxpayer and no interest in such machines was included in the capital account of any of his children. Moreover, the interlineations to the partnership agreement, attempting to show that taxpayer's father had an interest in the assets prior to the agreement (R. 165, 170)

itself indicates that there were no real gifts, as claimed, of business assets. And when this evidence is considered together with the obvious tax avoidance motive⁴ which resulted in the formation of the alleged partnership it becomes clear, we think, that no real gifts were made and no real partnership was intended.

Moreover, the fact that the taxpayer's children could not legally own interests in the business income-producing assets, the slot machine, also is good support for the Tax Court's finding that they did not acquire any interest in such assets. As noted by the Tax Court (R. 180-181), Idaho law, at the time the partnership was purportedly formed, legalized ownership of such machine only after a license was procured and such machines could not be operated on premises other than those owned by the licensee. Idaho law also provided that no person other than the licensee could have any interest whatever in such machines.⁵

⁴ The alleged partnership was created after the taxpayer's father read a magazine article pointing out possible tax savings through the use of the family partnership device. (See R. 55-56, 74; Ex. 8, R. 58.) The tax avoidance motive may be taken into account in determining the bona fides of the situation. See Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, Sec. 29.191-1(b) (10), as added by T.D. 6037, 1953-2 Cum. Bull. 213.

⁵ Sections 50-1503, 50-1504, 50-1509, Idaho Code (S.L. 1947, c. 151).

The taxpayer apparently misconstrues the opinion of the Tax Court on this point. (See Br. 33-34.) The Tax Court did *not* state that ownership of slot machines was illegal in Idaho during the tax years. The Tax Court pointed out, however, that ownership by the taxpayer's children would

Certainly, it was proper for the Tax Court to infer that the taxpayer did not really intend to transfer any interest in such machines to his children when such a transfer would not ^{be} ~~per~~ permissible under Idaho law.

There can be no doubt that on a reading of the entire record, the Tax Court's findings that no real gifts were made and that there was no real partnership formed, but rather that the entire transaction was a sham, are amply supported by the evidence. The Tax Court properly took into account all of the facts—facts existing before, during and after the taxable years—in arriving at its conclusions.⁶ These conclusions are certainly not clearly erroneous.⁷

have been illegal since they were not, and could not have been, licensees.

Moreover, it should be noted that although the Idaho statutes providing for legalized ownership of slot machines was repealed in 1953 (R. 163), it was not until 1954 that additional "capital contributions" were made on behalf of the children to compensate the loss of such assets in the business (R. 91-92). This, too, supports the Tax Court's findings as to lack of bona fides.

⁶ The taxpayer, on brief, in effect argues that other inferences, more favorable to his cause, could have been drawn by the Tax Court. It is well settled, however, that it is the Tax Court's function to draw inferences from the facts of record. That other inferences *might* be drawn is immaterial.

⁷ The taxpayer suggests that, in any event, the income should be taxed to his father and not to him since some of the gifts were allegedly made by his father. However, it is by no means clear from the record that any of the assets, in fact, had belonged to the father. As pointed out above, the partnership agreement originally described all of the assets

CONCLUSION

For the reasons stated, the Tax Court's decision should be affirmed.

Respectfully submitted,

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FEBRUARY, 1958.

as belonging to the taxpayer. (R. 165.) It was only after the Internal Revenue Service's investigation began (R. 170) that the father's name was inserted as being an owner of a share of the assets. Moreover, the business income was derived from the machines placed in a club, opened by taxpayer, in 1944. The machines originally were taxpayer's and he entered into an agreement with the club for a percentage of the receipts from the machines. No agreements were ever executed with the Spiesman and Spiesman partnership nor the Spiesman & Sons partnership. (R. 105-110.) There is no indication that the arrangement would continue without taxpayer's participation. In the circumstances, it is therefore proper to allocate all of the income from the machines to taxpayer.

No. 15752

United States Court of Appeals
FOR THE NINTH CIRCUIT

MATHEW J. SPIESMAN, JR., and
MARY SPIESMAN, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appeal from the Tax Court of the United States

REPLY BRIEF FOR PETITIONERS

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United States Court of Appeals

FOR THE NINTH CIRCUIT

MATHEW J. SPIESMAN, JR. and MARY SPIESMAN, <i>Petitioners,</i>	}	No. 15752
vs. COMMISSIONER OF INTER- NAL REVENUE, <i>Respondent.</i>		

Appeal from the Tax Court of the United States

REPLY BRIEF FOR PETITIONERS

INTRODUCTION

The Petitioners' main brief in this proceeding was filed with the Court on or about the 22nd day of January, 1958. The Respondent's brief was filed on or about the 5th day of March, 1958, pursuant to a stipulation agreed to between counsel for the parties. The Petitioners were served with the Respondent's brief on or about the 6th day of March, 1958. The Petitioners' reply brief is due on or before the 7th day of April, 1958.

PETITIONERS' REPLY TO RESPONDENT'S ARGUMENT

The Petitioner in his main brief has set out in detail the reasons why this Court should reverse the Tax Court of the United States in *Spiesman et ux vs. Commissioner* (1957), 28 TC 567. The Respondent in his brief asserts that the Tax Court of the United States properly decided the case and as a basis cites the following reasons:

1. That Section 340 of the Revenue Act of 1951 merely eliminated from the troublesome family partnership area the question of a partnership interest acquired by gift (Respondent's argument number 1, Respondent's brief, page 17).

2. That the Tax Court of the United States correctly applied the 1951 Revenue Act amending the family partnership law to the facts in the instant case and arrived at the proper conclusion that the five minor children of Petitioners did not receive their interest in the partnership by a bona fide gift and that the partnership was a sham (Respondent's argument number 2, Respondent's brief, page 22).

3. That the facts of record show conclusively that the Tax Court should be affirmed (Respondent's argument number 3, Respondent's brief, page 24).

All the arguments set forth in Respondent's brief are fully covered in Petitioners' main brief and the assignments of error thereunder, but a few comments are in order.

In analyzing the changes made by Congress by the Internal Revenue Act of 1951 (see Section 340, Internal Revenue Act of 1951) regarding partnerships, Respondent cites the same Committee Reports relied upon by the Petitioners in their main brief. Basically, the touchstone of the Congressional intent is set forth in the Committee Reports set out at page 20 of the Respondent's brief and at page 17 of the Petitioners' main brief. Specifically, it is stated that the Commissioner is still free to inquire into the validity of the family partnership in cases where the formation of the partnership by gift is a mere *sham*. As Petitioners have pointed out in their main brief, the word *sham* is to be accorded its real meaning. (See Petitioners' main brief pages 22 and 23). There is no *sham* present in the instant case.

As previously pointed out, Congress when the word *sham* was used necessarily had in mind a situation where a family partnership was utilized to minimize taxes and where the parent used the money allocated to the children for his own use. This position is recognized in the Committee Reports referred to in the Tax Court opinion (R. pps. 178, 179) wherein the following is quoted from the said Committee Reports:

“Not every restriction upon the complete and unfettered control by the donee of the property donated will be indicative of sham in the transaction. Contractual restrictions may be of the character incident to the normal relationships among partners. Substantial powers may be retained by the transferor as a managing partner

or in any other fiduciary capacity which, when considered in the light of all the circumstances, will not indicate any lack of true ownership in the transferee. In weighing the effect of a retention of any power upon the bona fides of a purported gift or sale, a power exercisable for the benefit of others must be distinguished from a power vested in the transferor for his own benefit."

Petitioners in their main brief have set forth in detail the reasons why the partnership involved herein was not a sham. It would be repetitious to repeat those reasons.

The Respondent in his main brief takes the view that the 1951 amendment to the law regarding the taxation of partnerships (Section 340 of the Revenue Act of 1951) only eliminated from consideration in family partnership cases one factor, i.e., that a valid family partnership could arise from a bona fide gift (Respondent's brief, page 22). The Respondent then asserts that giving full effect to this change the Tax Court of the United States correctly found in the instant case "that there were no bona fide gifts of interest in the machines which were the income-producing assets of the partnership, to the children, and the formation of Spiesman & Sons partnership was a sham." (Respondent's brief, page 23).

The Petitioners in their main brief have fully covered this argument. In attempting to substantiate the finding of *sham*, the Respondent's brief points to certain factors which although fully covered in Peti-

tioners' main brief bear additional mention. The Respondent states that several factors point to the correctness of the Tax Court's findings. First, it is asserted that the partnership agreement was not carried out in the important respect of the distribution of profits (Respondent's brief, page 24).

This argument confuses the basic distinction between withdrawals from a partnership and partnership distributable income. It is the latter which is important, not the former. The record amply illustrates that the partnership allocated the distributable partnership income in accordance with the partnership agreement to Petitioner, Mathew J. Spiesman, his father and Petitioners' five minor children during the taxable years involved herein. The record further discloses that the children of Petitioners filed income tax returns based on each child's proportionate share of partnership distributable income. It does not matter that each child did not withdraw his proportionate share. The important factor is that each child could have withdrawn his distributable share of partnership income. This Court has recognized the basic distinction, as pointed out above, between withdrawals and partnership distributable income. In *William P. Neil et. ux. vs. U. S.* (CA, 9-1935) 205 F. (2d) 121, this Court said:

"It is immaterial, if true, that only \$19,456.39 of William P. Neil's distributive share of the partnership's ordinary income for 1946, computed as provided in Section 183(b), was distributed to him; for, in computing their net incomes for

1946, appellants were required to include all of that share whether distributed or not."

The Respondent's brief in commenting upon the argument that there were unequal withdrawals cites at page 25 of Respondent's brief the excerpts from the record containing Petitioners' explanation of why unequal withdrawals were made. It should be noted that the Petitioner following the quoted testimony above testified further as follows:

"Q. Did you subsequently make an adjustment, in a subsequent year, on your accounting?

"A. I did, on this, in 1954. I think an adjustment is made, I am sure, I know it is, and the money that was withdrawn from, I mean the money that was held out of Joe and Phillip was credited to the three youngest boys, was returned to Joe and Phillip, the oldest boys.

"Q. This money was in the bank, or cash on hand, so that you had no trouble making the change back, of the money that had been expended?

"A. Yes; it is in the safe deposit books, records." (R. pps. 90, 91.)

The Petitioner, after he found out that he shouldn't have withdrawn an unequal amount in an attempt to equalize the balance of the children's accounts, did transfer the money back as he testified (see Exhibits J, K, L, M, and N). It must certainly be noted that the appropriate Probate Court sanctioned the action of Petitioner in every regard. Certainly if there was any impropriety in the actions of the Petitioner, the

Probate Court would not have acquiesced in the Petitioners' accounting.

The Respondent next asserts that the partnership agreement is an inconclusive instrument of conveyance and that this factor is therefore indicative of the Tax Court's finding that no bona fide gifts were made (Respondent's brief, page 26). Does this mean that the Respondent is asserting that there can be no bona fide gift of a partnership interest without a written conveyance? Certainly the basic common law elements of gift are here present, i.e., intent, delivery and acceptance. There is no requisite to be found anywhere in the tax law indicating that a partnership cannot be formed without a conveyance by instrument. And this would apply equally well to a conveyance of assets prior to the formation of a partnership or the gift of a partnership interest. See, for example, *William Weizer v. Commissioner* (CA, 6-1948), 165 F. (2d) 772, wherein an oral partnership was recognized as valid for tax purposes. The conveyance of a partnership interest or the assets of the partnership can be made orally for tax purposes. Certainly this would negate any assertion that a partnership cannot be bona fide or valid where there is no formal instrument of conveying either the partnership interest or the assets in the partnership to the donee. In any event, the partnership agreement itself can certainly operate as an instrument of conveyance for federal tax purposes.

The Respondent next mentions the Petitioners failure to file accountings as guardian for the children until after the Internal Revenue Service investigation was initiated (Respondent's brief, page 26). This argument by Respondent is answered fully in Petitioners' main brief at page 32 under the Argument on Assignment of Error III(a). However, it bears repeating that although late, the guardianship accountings were approved in every way by the Probate Court in and for Benewah County, Idaho (Exhibit 13). The most important factor is that the children received all of the money and that the State Probate Court fully recognized that.

The Respondent next alludes to the fact that the capital account of the partners on the partnership returns as filed, listed the machines as being owned by the Petitioner (Respondent's brief, page 26). The answer to this argument is fully set forth in Petitioners' main brief at page 27, Assignment of Error II(b). It should be noted that the depreciation on the said machines was distributed equally to the individual partners in computing their distributable share of partnership income. This factor, of course, should certainly bear upon the question of who owned the machines.

The Respondent next asserts that the interlineations on the partnership agreement show that there was no real gift (Respondent's brief, pages 26 and 27). The Petitioners in their main brief have set forth their position on the interlineations (Petition-

ers' brief, pages 24 and 25, Assignment of Error II(a)). The uncontroverted facts of record show conclusively that Petitioner's father owned a one-half interest in the machines prior to the transfer of the assets to the Spiesman & Sons partnership (Exhibit 9). This illustrates the reason for the interlineations on the partnership agreement. The testimony of Petitioner and his father is uncontroverted in this respect. The fact that the partnership did save tax is completely immaterial. The Respondent cites Regulations 111, Section 29.191-1(b)(10) as authority for his position on the tax-saving aspects of the partnership (see Respondent's brief, footnote 4, page 27). The Tax Court of the United States pointed out in its opinion (Transcript 180) that the regulations relied upon by the Respondent were not promulgated until August 18, 1953, and therefore have no applicability to the instant case.

The last reason set forth by Respondent for upholding the decision of the Tax Court is based upon an interpretation of the Idaho law which provided that no person other than a licensee can own any interest in slot machines (Respondent's brief, pages 27 and 28). The Petitioners' answer to this argument is set forth in Petitioners' main brief, pages 34 and 35 under the Assignment of Error III(b). Specifically, the Idaho law relied upon by the Tax Court and the Respondent is in direct conflict with the Federal law and the Federal law for tax purposes must therefore control. In any event, the state law is not determi-

native of the question of validity of family partnership. Aside from these reasons, however, the minor children of Petitioner did not have to have an interest in the assets of the partnership to be a valid partner since they had an interest in the partnership which is perfectly permissible under Idaho law.

Idaho enacted the uniform partnership act effective as of January 1, 1920. Section 53-326 of the Idaho Code is entitled "Nature of Partner's Interest in Partnership" and provides as follows:

"A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property."

This section of the Idaho law corresponds to Section 26 of the old Uniform Partnership Act. Section 53-326 above, contains no annotated cases on point but the annotations refer to Volume 68 of *Corpus Juris Secundum*, Section 85 under *Partnerships*, which provides in part as follows:

"Although title to it [firm assets] is held or taken in the name of one of the partners, the rule is that the partners do not, as individuals, own the firm property, but that it is held by, and belongs to, the partnership as such, and the partners do not as individuals, have any specific interest in any particular asset or particular part of the assets; nor can a partner assign or transfer an undivided share in any specific articles belonging to the partnership. The interest has been said to be a mere chose in action. It is property, or, more precisely, personal property . . ."

The Petitioners' minor children in the instant case owned a share in the partnership (i.e., a partnership interest). There is no question that a minor is capable of owning a partnership interest under Idaho law. The Idaho law concerning the ownership of the machines is nondeterminative on the question presented in this appeal.

In Petitioners' main brief, it was asserted that the Tax Court of the United States had erred in not allocating a portion of the income back to Petitioner's father (Assignment of Error IV, Petitioners' main brief, page 41). The Respondent in footnote 7 of his main brief, page 27, states:

“It is by no means clear from the record that any of the assets, in fact, belong to the father.”

The record, however, is quite clear that the assets did belong to the father. When the partnership between Petitioners and his father was first entered into (Exhibit 9 executed in 1950), Petitioner's father purchased a one-half interest in the machines (R. 61 and 62). The uncontroverted evidence shows that Petitioner's father prior to the formation of Spiesman & Sons owned the machines equally (Transcript 81, 82). The Respondent apparently confuses the two partnership agreements (Exhibits 9 and 10). It is the first partnership agreement (Exhibit 9) which shows uncontroverted that Petitioner's father owned an interest in the machines. Again, the Respondent has misconstrued Petitioners' argument and has failed to set forth any reason why the Tax Court should not be reversed under Assignment of Error IV, referred to above.

CONCLUSION

Petitioners in their main brief have illustrated the incorrectness of the Tax Court's decision here under review. The Respondent's main brief does nothing to disturb the reasoning behind Petitioners' arguments. The Tax Court of the United States has erred in failing to recognize the validity of the family partnership here involved.

Petitioner, his five sons and his father formed a family partnership. The partnership was valid in every respect. The proportionate share of the partnership profits during the years were set aside for the children and were not used for the maintenance and support of the children. None of the money allocated to the children was ever used by the Petitioner. The record shows that the money is still on deposit in the children's names. The partnership was no sham and the gifts to the children were valid in every respect. The decision of the Tax Court should therefore be reversed.

Respectfully submitted,

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Nos. 15757, 15758, and 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF.

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Nos. 15757, 15758, and 15759

IN THE

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Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF.

This is a joint appeal on behalf of Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins from final judgments entered July 29, 1957, in the companion cases of *Laurence V. Kanter v. United States of America*, *Ruth Wolins v. United States of America*, and *Jerome B. Kanter v. United States of America*; judgment in each of said cases was based upon substantially identical Findings of Fact and Conclusions of Law, and decreed that appellants take nothing by their respective individual complaints for the recovery of income taxes alleged to be erroneously and illegally collected. [R. 29-45.]

I.

PRELIMINARY STATEMENT.

On March 4, 1957, the above-named cases were jointly tried pursuant to stipulated facts and documentary exhibits; no testimony was offered or received into evidence. [R. 17-28, 47-81.] Following the entry of judgment in each case on July 29, 1957 [R. 45; Tr.* 77, 111] and the filing of Notices of Appeal in each case on September 19, 1957 [R. 46; Tr. 79, 113], a stipulation between counsel for the respective parties was entered into whereby it was agreed, in essence, that, while the certified record in the case of *Laurence V. Kanter v. United States of America* only would be printed, the entire records in the companion cases of *Laurence V. Kanter v. United States of America*, *Ruth Wolins v. United States of America*, and *Jerome B. Kanter v. United States of America* certified to this Court by the Clerk of the United States District Court for the Southern District of California, Central Division, are material to the consideration of this appeal, and that matters contained in the certified records which are not part of the printed record may be referred to by any party in briefs or arguments. [R. 87.] On October 22, 1957, Chief Judge Stephens endorsed an order permitting the filing of single briefs covering all three cases. [R. 90.]

*The designation "Tr." refers to the unprinted portions of the Transcript of Record sent to the clerk of the Court of Appeals for the Ninth Circuit by the clerk of the United States District Court.

II.

JURISDICTIONAL STATEMENT.

In re Appellant, Laurence V. Kanter:

On or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Laurence V. Kanter in the amount of eight hundred three dollars and seventy-two cents (\$803.72), plus interest, and on or about March 15, 1949, Laurence V. Kanter paid said amount, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. [R. 7, 8.] On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the years 1946 and 1947 against Laurence V. Kanter in the amount of three thousand four hundred eighty-eight dollars and sixty-four cents \$3,488.64), plus interest, and five thousand four hundred ninety-two dollars and sixty-two cents (\$5,492.62), plus interest, respectively. Laurence V. Kanter paid said amounts, plus interest. [R. 8, 9.] All of said deficiencies related to the inclusion in the gross income of Laurence V. Kanter of income of the trust of which he was the primary beneficiary.

On or about August 12, 1950, Laurence V. Kanter filed a written claim for refund of the sum of eight thousand six hundred fifty dollars and thirty-three cents (\$8,650.33), plus interest, for income taxes and interest allegedly erroneously collected from him. [R. 9.] On April 5, 1951, the Commissioner of Internal Revenue dis-

allowed the claim for refund respecting the years 1946 and 1947; disallowance of the claim for refund respecting the year 1945 was not received by Laurence V. Kanter within six (6) months of the time of the filing of his claim. [R. 9, 10, 12.]

On April 3, 1953, Laurence V. Kanter, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [R. 3.] The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against Laurence V. Kanter were filed July 26, 1957, and judgment entered on July 29, 1957. [R. 29.]

Notice of Appeal from the final judgment was filed September 19, 1957. [R. 46.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

In re Appellant, Ruth Wolins:

On or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Ruth Wolins in the amount of eleven hundred twenty-nine dollars and thirty cents (\$1,129.30), plus interest, and on or about March 15, 1949, Ruth Wolins paid said amount, plus interest, to

the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes against Ruth Wolins in the amount of four thousand four hundred eighty-two dollars and seventy cents (\$4,482.70), plus interest, respecting the year 1946 and eight thousand two hundred seventy-eight dollars and seventy-seven cents (\$8,278.77), plus interest, respecting the year 1947. On or about June 9, 1949, Ruth Wolins paid both of said amounts, plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. All of said deficiencies related to the inclusion in the gross income of Ruth Wolins of income of the trust of which she was the primary beneficiary.

On or about August 12, 1950, Ruth Wolins filed a written claim for refund of the sum of nine thousand seven hundred eighty-two dollars and fifty-three cents (\$9,782.53), plus interest, for income taxes and interest allegedly erroneously collected from her. On April 18, 1951, the Commissioner of Internal Revenue disallowed the claim for refund respecting the years 1945, 1946 and 1947.

On April 16, 1953, Ruth Wolins, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central

Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [Tr. 62, *et seq.*]

The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C.. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against plaintiff were filed July 26, 1957, and judgment was entered July 29, 1957. [Tr. 62.]

Notice of Appeal from the final judgment in said action was filed on September 19, 1957. [Tr. 79.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

In re Appellant, Jerome B. Kanter:

On or about January 7, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Jerome B. Kanter in the amount of three hundred seventy-five dollars and thirty-two cents (\$375.32), plus interest, and on or about March 15, 1949, Jerome B. Kanter paid said amount, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. On or about May 20, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes against Jerome B. Kanter in the amount of two thousand four hundred sixty-one dollars and twenty-three cents (\$2,461.23), plus interest, respecting the taxable year 1946 and three thousand six hundred twenty-four dollars and seventy-four cents (\$3,624.74), plus interest, respecting the taxable year 1947. Jerome B. Kanter paid both of said amounts, plus interest, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. All of said deficiencies

related to the inclusion in the gross income of Jerome B. Kanter of income of the trust of which he was the primary beneficiary.

On or about August 12, 1950, Jerome B. Kanter filed a written claim for refund of the sum of five thousand eighty-two dollars and ninety-one cents (\$5,082.91), plus interest, for income taxes and interest allegedly erroneously collected from him. On May 24, 1951, the Commissioner of Internal Revenue disallowed the claim for refund respecting the calendar years 1945 and 1947; disallowance of the claim for refund respecting the year 1946 was not received by Jerome B. Kanter within six (6) months of the filing of his claim.

On May 21, 1953, Jerome B. Kanter, a resident of the County of Los Angeles, State of California, within the Sixth Internal Revenue Collection District of the State of California, filed a civil action in the United States District Court for the Southern District of California, Central Division, seeking recovery of the individual income taxes and interest thereon allegedly erroneously and illegally collected. [Tr. 83 *et seq.*]

The United States District Court had jurisdiction pursuant to Section 1346(a)(1) of 28 U. S. C.. Findings of Fact, Conclusions of Law and Judgment in favor of defendant and against plaintiff were filed July 26, 1957, and judgment was entered July 29, 1957. [Tr. 96.]

Notice of Appeal from the final judgment was filed September 19, 1957. [Tr. 113.] The jurisdiction of this Court to review the final judgment is conferred by Section 1291 of 28 U. S. C.

III.

STATEMENT OF THE CASE.

(A) Question Presented.

The sole question presented by this consolidated appeal is whether, during the taxable periods in question, the years 1945, 1946, and 1947, the income of three (3) irrevocable trusts, accumulated and undistributed in accordance with the terms of the trust instruments, should be attributed and taxable to the appellants, as primary beneficiaries of the respective trusts, because of the similarity of the provisions of the trust instruments and the business and familial relationships existing between the trustees and the primary beneficiaries.

All evidence received during the joint trial of the three (3) cases was comprised of stipulations of fact entered into between counsel for the respective parties and documentary exhibits. All of said evidence is contained in the record on appeal. [R. 17-28, 47-81.] The sole question involved was raised in briefs filed in the District Court. The question for review before this Court is whether the District Court correctly applied the legal principles applicable to the undisputed evidence. Appellate review is preserved by virtue of Rule 52(b) of the Federal Rules of Civil Procedure. *Monaghan v. Hill*, 140 F. 2d 31 (9th Cir., 1944).

(B) Statutes and Regulations Involved.

Pertinent provisions of applicable Statutes and Treasury Regulations which are referred to and which are not sufficiently set forth in the body of this brief are contained in the appendix.

(C) Statement of Undisputed Facts.

(1) Background.

During the early part of the year 1944, the Kanter family owned all of the stock of Shop 'N Save, a California corporation. The three (3) children, Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins, each owned 6.81 per cent of the stock, the father, Harry L. Kanter, owned 13.31 per cent of the stock and the mother, Minnie Kanter, owned the remaining 66.26 per cent of the stock. [R. 31.]

On March 3, 1944, Minnie Kanter, desiring to make gifts of portions of her stock interest, created three (3) separate trusts for the benefit of her three children and the potential benefit of the issue of her children. No business purpose existed for the gifts and trusts created thereby. [R. 18, 31.] In all respects the gifts were valid, Minnie Kanter having effectively parted with all control over the property transferred in trust and having paid gift taxes on the transfers. [R. 19, 31.] In effecting the gifts, the trust medium was employed in order to reduce the income taxes that the children would have to pay on the income from the property gifted to them. [R. 31, 74.] In assessing gift taxes due, the Commissioner of Internal Revenue would not allow the three-thousand (\$3,000.00) annual exclusion for gifts to individuals, contending that the transfers in trust represented gifts of future interests. The benefits of the three thousand dollar annual exclusion claimed by Minnie Kanter in her tax return filed March 15, 1945, were thus denied and she accordingly paid a gift tax deficiency of seven hundred forty-two dollars and fifty cents (\$742.50). [R. 20.]

(2) Principal Provisions of the Trust Instruments.

(a) TRUSTEES AND PRIMARY BENEFICIARIES.

The trustees of the trusts wherein Laurence V. Kanter was the primary beneficiary, hereinafter sometimes referred to as the Laurence V. Kanter Trust, were Laurence's sister, Ruth Kanter Wolins, and her husband, Albert Wolins. The trustees of the trust wherein Jerome B. Kanter was the primary beneficiary, hereinafter sometimes referred to as the Jerome B. Kanter Trust, were Ruth Kanter Wolins and Laurence V. Kanter, sister and brother respectively of Jerome. The trustees of the trust wherein Ruth Kanter Wolins was the primary beneficiary, hereinafter sometimes referred to as the Ruth Kanter Wolins Trust, were her husband, Albert Wolins, and her brother, Laurence V. Kanter. [R. 18, 32.]

Paragraph "Twelfth" of the respective trust instruments provided that the trustees shall be joint trustees and their joint signatures necessary for the performance of any acts. Paragraph "Twelfth" provided additionally that the Bank of America National Trust and Savings Association would become the trustee in the event that both trustees could not or would not act. [R. 56.] Pursuant to the second paragraph of the trust instruments, the trustees had broad investment powers over the trust corpus. [R. 48.]

(b) SECONDARY BENEFICIARIES.

Pursuant to the terms of the Ruth Kanter Wolins Trust, Albert Wolins, Laurence V. Kanter and Jerome B. Kanter were "secondary beneficiaries" thereof, Albert Wolins possessing an interest in the trust property contingent on Ruth's death before January 2, 1960, and

Jerome B. Kanter and Laurence V. Kanter having interests contingent on Ruth's death before January 2, 1960, without lawful issue or a lawful spouse surviving her. Likewise, in addition to being trustees of the Jerome B. Kanter Trust, Ruth Kanter Wolins and Laurence V. Kanter were "secondary beneficiaries" thereof, each having interests contingent on Jerome B. Kanter's death before January 2, 1960, without lawful issue or lawful spouse surviving him. Jerome B. Kanter and Ruth Kanter Wolins were likewise similar contingent and "secondary beneficiaries" of the Laurence V. Kanter Trust. [R. 32, 51.]

(c) ACCUMULATION AND DISTRIBUTION OF TRUST
INCOME.

The third paragraph of each of the trust instruments provided that the term of the trust was established at fifteen (15) years and ten (10) months. After dividing this term into three (3) parts, the trust instruments provided that all income from March 3, 1944, to January 2, 1950, "shall be held in said Trust Estate as undistributed income and shall be available for distribution and shall be distributed to the beneficiary hereof on the 2nd day of January, 1950." [R. 50.]

The fifth paragraph in each of the trust instruments provided that:

"In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation." [R. 52.]

Paragraph "Sixth" of the respective trust instruments contained provisions prohibiting the sale, assignment, hypothecation, or transfer by any beneficiary of any beneficial interest in the trust estate and required the personal receipt of the designated beneficiary as a condition precedent to payment to such beneficiary. [R. 52.]

There is no power existing in any party to invade the corpus of the respective trust estates.

(3) Events During the Taxable Years in Question.

On or about April 1, 1944, Shop 'N Save Corporation was partially liquidated and a limited partnership under the name of Kanter & Wolins was organized. On the partial liquidation of the corporation, the shares of capital stock held by the shareholders were cancelled in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. The shares of capital stock which were to have been placed in the corpus of each trust executed by Minnie Kanter were thus cancelled, and the value of the corpus of each trust was credited to the capital account of each trust on the books of the Kanter & Wolins partnership. [R. 18, 33.]

All transactions affecting the trusts were reflected in the capital accounts of the trusts as limited partners on the books of the partnership. A Certificate of Limited Partnership was executed and filed in the office of the County Recorder of Los Angeles County on April 1, 1944. This Certificate showed that the general partners were Harry L. Kanter, Laurence V. Kanter, and Albert L. Wolins; the limited partners were Minnie F. Kanter, Jerome B. Kanter, Ruth Wolins, the trusts with which we are concerned and a fourth trust not involved in these proceedings. [R. 33.]

During the years 1945, 1946 and 1947, the taxable periods in question, the limited partnership filed income tax returns on which it listed each of the aforementioned trusts as being limited partners, and as such chargeable with their distributable shares of the partnership profits. During such years, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Kanter Wolins Trust did not distribute any part of the trust income to the beneficiaries. [R. 19, 35.]

(4) Liability for and Payment of Taxes.

On or before the 15th day of March, 1946, the 15th day of March, 1947, and the 15th day of March, 1948, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Kanter Wolins Trust prepared and filed on behalf of each trust fiduciary income tax returns for the calendar years 1945, 1946 and 1947, respectively. In each fiduciary return the trust's 6.81 percentage of the distributable share of the Kanter & Wolins partnership income for the aforesaid taxable years was reported. [R. 20-21, 35.] Because such trust income was not distributed to the beneficiaries, the returns reported and showed a tax payable by the respective trusts on account of such income. The income taxes due respecting such income were duly paid by the trustees of each of the trusts to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. [R. 20-22, 35.]

Thereafter, the Commissioner of Internal Revenue determined that the income of the trusts of which each of the appellants was the primary beneficiary was includible in their individual gross income and assessed deficiencies accordingly. The alleged deficiencies were paid, timely

claims for refund filed and subsequently disallowed or not acknowledged within six (6) months of the time of the filing of the claims. [R. 22-27, 36.]

Timely suits for refund were instituted in the District Court, by each appellant, seeking recovery of the amounts claimed in their claims for refund together with interest. [R. 3, Tr. 49, 83.]

IV. SPECIFICATION OF ERRORS.

The Trial Court erred:

(1) In admitting into evidence Defendants' Exhibit "B"; this exhibit, a second supplementary stipulation of facts between counsel for the respective parties, contained principally a series of statements of events pertaining to years subsequent to the taxable years in question; viz, acquisition by the Kanter & Wolins partnership of stock in a corporation in the year 1950 and loss resulting from said acquisition in later years. [R. 77-81.] For this reason, admissibility of this evidence was objected to on grounds of irrelevancy and immateriality. [R. 77.]

Most of the tax legislation of the past two decades amply illustrates that the incidence of the income tax is apportioned between a trust and its beneficiaries on a year-by-year basis; *e.g.*, 65 day and 12 month rules, Section 111 of the Revenue Act of 1942. The events and transactions of the particular taxable year in question determine the incidence of taxation for that year. *Burnet v. Sanford & Brooks Company*, 282 U. S. 359, 51 S. Ct. 150 (1931). Thus, it has been held that, in order to tax the undistributed income of a discretionary trust to the beneficiaries under Section 22(a) of the Internal

Revenue Code of 1939 on the theory that they could have demanded payment of the income, it is essential that the right to demand payment exist during the taxable year in question. Section 6.27 of Kennedy, *Federal Income Taxation of Trusts and Estate* (1948); *Hallowell v. Commissioner of Internal Revenue*, 160 F. 2d 536 (3rd Cir., 1947; *Samuel B. Knight*, 6 T. C. 90 (1946) (Acq.). In this regard, the events of subsequent years are not material. Cf., *Parker v. Westover*, 221 F. 2d 603 (9th Cir., 1955).

(2) In finding [in its Finding of Fact No. XXVI in each case] that the beneficiaries of the trusts had unlimited power and control over the corpus of the trusts in that said Finding of Fact is contrary to law, is not supported by any substantial evidence in the record and is not inferable from the reasons so stated in support of said Finding, to wit, the reciprocal nature of the trusts, the lack of independent trustees, the close familial, business and trust relationship of the trustees with each other, and the unlimited power in invasion of the corpus.

The respective trustees and beneficiaries were not settlors of the trusts in question; thus, although, the provisions of the respective trusts are identical except for the differences in the trustees and beneficiaries, the trusts were not "reciprocal"; *i.e.*, they were not created in consideration of the creation of the others.

Again because the respective beneficiaries were not the settlors of any of the trusts in question and hence did not select the fiduciaries, the relationship of the beneficiaries to the trustees does not establish that the trustees are amenable to the beneficiaries.

Nowhere in any of the provisions of the trusts in question is there any power to invade the trust corpus.

(3) In failing to find as a fact that there was no evidence that the beneficiaries of the trusts had any express power over the corpus or income of the trusts or had exercised any control over the corpus or income of the trusts.

No provision of the trust instruments gave the beneficiaries any power over the corpus or income of the respective trusts. Further, there is no evidence that any beneficiary actually exercised any control over the corpus or income of the trusts.

(4) In concluding (in its Conclusion of Law No. II in each case) that the plaintiffs have failed to sustain their burden of proof that they have overpaid income taxes for the years 1945, 1946 and 1947, in that said Conclusion of Law is contrary to law, contrary to the evidence and inconsistent with the District Court's Findings of Fact numbered XI, XII and XVII.

Findings of Fact numbered XI, XII and XVII demonstrate that the trustees had discretion to distribute or accumulate income, that they did not distribute any income and hence paid income taxes on the accumulated amounts accordingly. Since the respective beneficiaries never received a distribution during the taxable years in question, they are not taxable on the trust income. Sections 161(a)(4) and 162(c) of the Internal Revenue Code of 1939.

(5) In concluding (in its Conclusion of Law No. III in each case) that the undistributed income of the trusts was the income of the beneficiaries as earned by the Kanter & Wolins partnership and was properly taxed to the beneficiaries rather than to the trust in that said Conclusion of Law is contrary to law, contrary to the

evidence and inconsistent with the District Court's Findings of Fact numbered XI and XII.

This conclusion is erroneous for the same reasons stated in Specification of Errors No. 4 above.

(6) In concluding (in its Conclusion of Law No. IV in each case) that the beneficiaries had such control over the corpus of the trusts as to make the income therefrom their own in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

No provision of the trust instruments gave the beneficiaries any power over the corpus or income of the respective trusts; further, there is no evidence that any beneficiary actually exercised any control over the corpus or income of the trusts.

(7) In concluding (in its Conclusion of Law No. V in each case) that the three (3) trusts established by Minnie Kanter lacked substance and reality and were not valid under the income tax laws in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

(8) In concluding (in its Conclusion of Law No. VI in each case) that the beneficiaries of the respective trusts were as much the owners of the income paid by the Kanter & Wolins partnership to the various trusts as they were with respect to the income paid directly to them as limited partners in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record.

(9) In failing to conclude as a matter of law that the undistributed income of the respective trusts was the income of the trust and not the income of the beneficiaries thereof.

This conclusion followed from the reasoning stated in Specification of Errors No. 4 above.

(10) In failing to conclude as a matter of law that plaintiffs overpaid their income taxes for the years 1945, 1946 and 1947, and are entitled to recover from the defendant the amounts so paid, together with interest thereon as provided by law.

The income for the years in question was accumulated and thus properly taxed to the respective trusts.

V.

SUMMARY ARGUMENT.

Whether there is warrant in the record and a reasonable basis in the law for the legal conclusion of the District Court that appellants were in substance the owners of the respective trust estates is a judicial question subject to review by this Court.

1.

The trusts were "discretionary trusts." Pursuant to Sections 161(a)(4) and 162(c) of the Internal Revenue Code of 1939, a beneficiary of a "discretionary trust" is taxed only upon distributions received by said beneficiary. Income which is accumulated by the fiduciary is taxable to the trust.

All income for the taxable years in question was accumulated; none was distributed. Income taxes were therefore properly attributed and taxable to the trusts and not to the appellants as beneficiaries thereof.

2.

An exception to the statutory pattern of taxation arises when income is subject to one's unfettered command during the taxable year, in which event he may be taxed on such income whether or not he elects to receive it.

However, trust income or corpus is subject to a person's unfettered command only where a provision of the trust instrument gives such person express power over the trust income or corpus tantamount to ownership or where, absent such express power, such person actually enjoys the income.

None of the provisions of the trust instruments in question provided the appellants with power to deal with the trust property in a manner consistent with ownership, nor was any of the income of the trusts received by appellants.

3.

The reasoning expressed by the District Court in support of its Findings and Conclusions that the appellants, as beneficiaries of the respective trusts, had unlimited power and control over the corpus of the trusts, has no foundation in law or fact.

(a) Nowhere in any of the trust instruments is there a power to invade trust corpus;

(b) Although the provisions of the respective trusts are similar, the trusts are not "reciprocal"—they were not created by the appellants in consideration of the creation of the others. There is thus no reason in law or fact to transpose the positions of the appellants and trustees;

(c) There is no evidence of the exercise of control on the part of the appellants, and no inference arises that, because of the relationship of the trustees and appellants, the trustees are amenable to the appellants.

Under the *Clifford* decision, the concept of family unity is an economic consideration rather than one of conduct and behavior.

An inference arises that, because the “secondary” interests of the trustees in the trusts are “substantially adverse” to that of the appellants, the trustees are not amendable to the appellants.

Pursuant to the explicit provisions of Treasury Regulations 111, Section 22(a)-22, only when a person other than the grantor is *solely* empowered to control trust income or corpus is the trust income attributed to such person.

4.

Substantial and irrevocable gifts were made through the creation of the trusts; the donor effectively parted with all control over the trust property. Tax savings motives do not thereby render the trusts invalid.

Absence of a business purpose in establishing the trusts, when the presence of such purpose would have resulted in taxation of the trusts as corporations, is immaterial.

Conclusion.

Firmly established precedent which requires that one who does not receive income have, at least, the right to receive it before he may be taxed thereon, has not been followed by the District Court in these matters. The decision of the District Court results in appellants being taxed on something they neither received nor were in a position to demand the receipt of.

The intent of Congress, expressed in recent statutory enactments, is that specific statutory guides should be followed in rendering decisions based upon the “*Clifford*” doctrine. The guides have not been followed by the District Court in these matters.

VI.
ARGUMENT.

Whether the appellants, as primary beneficiaries of the trust instruments in question, had sufficient control over the trust property to make them the owners thereof, so as to be subject to taxation on the income therefrom, is a question of law subject to appellate review. *Hall v. Commissioner of Internal Revenue*, 150 F. 2d 304 (10th Cir., 1945); *Helvering v. Bok*, 132 F. 2d 365 (3rd Cir., 1942). Additionally, because all of the evidence before the District Court consisted of undisputed facts and documentary exhibits, this Court may consider the evidence *de novo*; *Smyth v. Barneson*, 181 F. 2d 143 (9th Cir., 1950), and may draw its own inferences therefrom; *Pacific Portland Cement Company v. Food Machinery and Chemical Corporation*, 178 F. 2d 541 (9th Cir., 1949).

1.

The Trusts Were “Discretionary” Trusts and All Accumulated Income Was Properly Attributable and Taxable to the Trusts and Not to the Primary Beneficiaries.

Pursuant to the terms of the fifth paragraphs in each of the trust instruments with which we are concerned, the accumulated income of the respective trusts could be distributed to the beneficiaries at any time in the discretion of the trustees [R. 52]; thus, as such, the trusts were so-called “discretionary trusts.” The statute itself provides how the income of a so-called “discretionary trust” shall be taxed. Section 161(a)(4) of the Internal Revenue Code of 1939 provides, in part, that

“The taxes imposed by this chapter . . . upon individuals shall apply to the income of estates or

of any kind of property held in trust, including . . .
(4) Income which, in the discretion of the fiduciary,
may be either distributed to the beneficiaries or ac-
cumulated.”

Section 162(c) of the Internal Revenue Code of 1939,
as pertinent, provides that,

“The net income of the . . . trust shall be com-
puted in the same manner and on the same basis as
in the case of an individual except that . . . (c)
in the case of income which, in the discretion of the
fiduciary, may be either distributed to the benefi-
ciary or accumulated, there shall be allowed as an
additional deduction in computing the net income
of the . . . trust the amount of the income of the
. . . trust for its taxable year, which is properly
paid or credited during such year to any . . .
beneficiary, but the amount so allowed as a deduction
shall be included in computing the net income of the
. . . beneficiary;”

Thus, if income were retained and accumulated by the
fiduciary, it would be taxable to the trust. If the fiduciary
distributed income, the trust would obtain credit through
a special deduction and the beneficiary would report the
income.

Counsel for the Government have stipulated that none
of the trust income for the taxable periods in question was
distributed to the appellants [R. 19-21]; the tax on said
income was therefore properly attributed and taxable to
the trusts. Income tax was accordingly paid on the in-
come by the respective trustees pursuant to the express
provisions of the revenue law. The law does not require
more.

Despite the express terms of the trust instruments and regardless of the agreed stipulated fact that no distribution of trust income was made to any of the appellants during the taxable years in question, the District Court has attributed the entire undistributed income of these periods to the appellants, as primary beneficiaries of the respective trusts, because it concluded that they had "unlimited control over the corpus of the trusts"; the reasons expressed for this conclusion are the reciprocal nature of the trusts, the lack of independent trustees, the close familial, business and trust relationship of the trustees with each other, the unlimited powers of invasion of the corpus and the fact that the creation of the trusts had no business purpose and was motivated with tax savings in mind. [R. 42.]

This general conclusion of the District Court was undoubtedly based upon the large body of case law which has developed since the renowned decision of *Helvering v. Clifford*, 309 U. S. 331, 60 S. Ct. 554 (1940), and Treasury Regulations supplementing these decisions (Appendix) dealing with the interrelation of Section 22(a) and Sections 161 and 162 of the Internal Revenue Code of 1939.

The theme of these many cases may be summarized as follows:

Where income is subject to one's unfettered command during the taxable year and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not.

In determining whether or not income is subject to one's unfettered command during the taxable year, all of the reported decisions point to a simple basic premise:

2.

Income or Corpus Is Subject to a Person's Control Only Where the Trust Instrument Gives Such Person Express Power Over Trust Income or Corpus Tantamount to Ownership or Where, Absent Such Express Power, There Is Evidence of Actual Power Exercised.

Probably the leading case sustaining this premise is *Mallinckrodt v. Nunan*, 146 F. 2d 1 (8th Cir., 1945). On page 1 of this opinion, the Court aptly sums up the crux of the case by stating,

“By the *terms* of the instrument creating the trust, this undistributed income was *payable to petitioner* (trust beneficiary) annually *upon his request*, but, if not paid to him at his request, it was to be added to the corpus of the trust estate at the end of each year.” (Italics and reference added.)

The Court phrased the issue as follows:

“The question presented is whether the undistributed income of the trust in the years in question was taxable to petitioner or taxable to the trust.”

and briefly concluded,

“Since the trust income in suit was available to petitioner upon request in each of the years involved, he had in each of those years the ‘realizable’ economic gain necessary to make the income taxable to him.”

The *Frank*, *Stix* and *Spies* cases, appearing in 145 F. 2d 413 (3d Cir., 1944), 152 F. 2d 562 (2d Cir., 1945), and 180 F. 2d 336 (8th Cir., 1950), respectively, are essentially indistinguishable from the *Mallinckrodt* case. In the *Frank* case, the beneficiary was given express power in the trust instrument to receive up to 50% of trust in-

come each year; in the *Stix* and *Spies* cases, the beneficiaries were also sole trustees and as such expressly empowered to pay over to themselves trust principal and income. Trust income was therefore properly attributed to the person thus expressly empowered in each of these cases.

In *Bunting v. Commissioner*, 164 F. 2d 443 (6th Cir., 1947), petitioner, the son of the grantor of the trust and neither a beneficiary nor a trustee, was given express power in the trust instrument to modify, amend, or add to the trust in any respect whatsoever, power to appoint himself as a beneficiary and power to revoke the trust instrument whereupon all trust income would be paid to petitioner. Similar to the *Bunting* case are the *Emery* case, 156 F. 2d 728 (1st Cir., 1946), the *Jergens* case, 136 F. 2d 497 (5th Cir., 1943), as well as *Corliss v. Bowers*, 281 U. S. 376, 50 S. Ct. 336 (1930). In all of said cases, there were provisions in the trust instruments which gave the taxpayer, whether he happened to be grantor, trustee, beneficiary, or third person, *express* power to deal with the income or corpus, as the particular case happen to be, in a manner consistent with ownership. Income of the trust was therefore properly attributable to said taxpayers.

No such express power is given the appellants in the trust instruments with which we are herein concerned. There is not one shred of evidence to sustain the District Court's Finding that the appellants, as primary beneficiaries of the respective trusts, had "unlimited power of invasion of the corpus." No such power existed. Unlike taxpayers in the above cited decisions, the appellants had no power to accept or reject payment of income annually, or to withdraw any part of the trust corpus, or to alter, amend, or modify the trusts. Under such circumstances,

when appellants did not receive any income and were not empowered to receive any income, there is no warrant for attributing and taxing the income of the trusts to them.

In *W. C. Cartinhour*, 3 T. C. 482 (1944), (Acq.), consideration was given to several decisions pertinent to this appeal. In this case, a husband and wife joined in the creation of a trust for the benefit of their minor children, the husband contributing non-income producing insurance policies upon his life and the wife contributing income producing policies. The husband and a banking company were named as co-trustees. The trustees were empowered to hold and manage the trust funds

“with full power to invest and reinvest any part of the trust estate according to their sole judgment and discretion and are not to be subject to any restriction or limitation by reason of the laws of the State of Tennessee with respect to investments of trust funds so long as Cartinhour (the husband) shall be one of the trustees. . . .” (Reference added.) 3 T. C. 482 at 484.

Additionally, the trustees were directed to disperse the share of the income to the beneficiaries of the trust “in such manner, for the support, education and assistance of such child as the trustees in the exercise of their judgment may deem proper.” 3 T. C. 482 at 485. The trustees also had power to encroach on the trust corpus for the support, education and assistance of the beneficiaries.

The husband was given the further right, during his life, to request the resignation of the named bank as trustee and to appoint a successor trustee, and in the event of difference of views between the co-trustees in voting the shares of stock, the views of the individual trustee or

trustees were to prevail. On page 486, the Court states as follows:

“Respondent’s (Commissioner) first contention is that Cartinhour is taxable upon the income of the trust under the provisions of Section 22(a). . . .”

and continued as follows on page 488,

“While it is apparent from the above, that petitioner was given broad powers over the trust corpus and income, they were not, in our opinion, quite so broad or far reaching as were those given to the taxpayers in the two cited cases. He did not have the power to withdraw all or any part of the corpus of the trust, or to alter, amend or modify, or revoke it in whole or in part, possessed by the taxpayer in the *Jergens* case, nor did he have the right to terminate the trust at any time and to take over the trust property as his own, such as was possessed by the taxpayer in the *Richardson* case. The question arises, therefore, whether the absence of these powers is sufficient to distinguish the instant proceedings from those relied upon by the respondent. In other words, can it be said, as was said in those cases, that the property and the income therefrom was *so clearly subject to petitioner’s unfettered command that they were, in substance, his?*” (Italics added.)

After discussing several cases the Court summarized as follows, on page 489:

“The control over the income exercised by the grantor must be ‘very substantial’ if the income is to be considered his.

“While it is true that Cartinhour was given rather broad powers with respect to the management of the trust estate, they were given to him in the fiduciary capacity of trustee, and not as an individual. As

heretofore pointed out, he did not have the power to alter, amend, revoke, or terminate the trust, nor could he vest title to the corpus in himself. The only benefit he could receive from the income was in the event he and his co-trustee exercised the discretionary power given to them to distribute it for the support, education, or assistance of the beneficiaries, his minor children. The discretionary power was not exercised and no part of the income was used for this purpose during the taxable years.”

Appellants, like the petitioner in the *Cartinhour* case, had no power to revoke, amend or modify the trusts in any way whatsoever; the only benefit appellants could receive from the trusts during the taxable years in question was in the event they, or any one of them, prevailed upon the particular co-trustees to exercise their discretion to distribute income. Again like *Cartinhour*, “. . . no part of the income was used for this purpose during the taxable years.”

It is readily conceded that, had appellants, or any one of them, obtained whatever they desired of the trust income during the taxable periods in question, there would be evidence of an actual exercise of control sufficient to require attribution of all trust income for such periods to appellants, or any one of them, as the case might be. This, of course, would take us beyond the *Cartinhour* case and into a factual situation similar to *Franklin Flato*, 14 T. C. 1241 (1950), aff'd 195 F. 2d 580 (5th Cir., 1952).

In the *Flato* case, a mother and father each created three trusts, one for the benefit of each of their three sons. The first son, Franklin, was the sole trustee of the two trusts for the second son, Frederick, who was the sole trustee of the two trusts for Franklin. Franklin and

Frederick were co-trustees of the two trusts for the third son, Robert. Distributions of trust income were to be made at the discretion of the trustees. On page 1245 of 14 T. C. (1950), the Tax Court stated:

“Three bank accounts were maintained, one for each group of trusts. From the deposits in the bank accounts of the trusts, distributions were made to the petitioners as beneficiaries of the respective trusts as follows: In 1941, to Robert, \$2500.00 from each trust, or a total of \$5000.00; in 1942, to Frederick, \$2000.00 from each trust, or a total of \$4000.00; to Robert, \$2000.00 from each trust, or a total of \$4000.00; to Franklin, \$1100.00 from each trust, or \$2200.00, as a contribution to his church; in 1943, to Frederick, \$3500.00 from each trust, or a total of \$7000.00. The distributions made to Robert in 1941 and 1942 were made because of a request made by him in which he stated that he needed the money. The distributions to Frederick were made because of a request and his statement that he needed money to live on and in 1943 he wanted money to buy a farm. The contributions to the church made from Franklin’s trusts were at his request.”

On page 1248, the Tax Court concluded:

“The evidence indicates that the beneficiaries requested and got such amounts of trust income as they desired. The fair inference is that they got what they wanted.”

Accordingly, in the *Flato* case, all of the income of the trusts for the taxable periods in question was attributed to the beneficiaries.

There can be no doubt that if the appellants “got what they wanted” of the trust income during the taxable years in question, there would be evidence of an actual exercise

of power over the trust income indicative of control. However, there have been *no distributions* to any of the appellants during any of the taxable periods in question [R. 19, 35]; further, there is no evidence that any of the appellants could have “got what they wanted” of the trust income. In short, there is no substantial evidence whatever to support the District Court’s Findings and Conclusions which attributed the entire undistributed income for the taxable years in question to the appellants as primary beneficiaries. Income taxation was never designed to exact tribute from a source that did not receive income and was incapable of commanding the receipt of income.

3.

The Reasoning Expressed by the District Court in Support of Its Findings and Conclusions That the Appellants, as Beneficiaries of the Respective Trusts, Had Unlimited Power and Control Over the Corpus of the Trusts—To-wit, the Reciprocal Nature of the Trusts, the Lack of Independent Trustees, the Close Familial, Business and Trust Relationship of the Trustees With Each Other and the Unlimited Powers of Invasion of the Corpus—Has No Foundation in Law or Fact.

(a) There Is No Power to Invade Corpus.

As has been stated heretofore, nowhere in any of the trust instruments in question is there a power to invade the trust corpus.

(b) The Trusts Are Not “Reciprocal Trusts.”

Secondly, the relevancy of the fact that the provisions of the respective trust instruments are essentially identical is not clear. While its line of reasoning is not clear, apparently the District Court would transpose the various

trustees and primary beneficiary of the same trust pursuant to the so-called "reciprocal trust" doctrine. If such is the case, the District Court's reasoning does violence to the essence of the "reciprocal trust" doctrine cases.

The "reciprocal trust" doctrine is applied only where one who has furnished consideration for the creation of a trust by another is empowered, pursuant to the provisions of the trust instrument, to do certain acts which would require attribution of the income to him had *he* made the transfer in trust. *Commissioner of Internal Revenue v. Warner*, 127 F. 2d 913 (9th Cir., 1942); *Lehman v. Commissioner of Internal Revenue*, 109 F. 2d 99 (2d Cir., 1940), certiorari denied, 310 U. S. 637, 60 S. Ct. 1080 (1940); *Estate of Louise De Witt Ruxton*, 20 T. C. 487 (1953).

As applied, the "reciprocal trust" doctrine places one who has furnished consideration for a transfer in trust in the position of the grantor; any controls that such person may then have are considered "retained" and not "acquired," thus bringing into play the various incidence of income and estate taxation effective when controls are retained by a "grantor." *E. g.*, Sections 166, 167 and 811 of the Internal Revenue Code of 1939. (Appendix.)

In the cases with which we are concerned, all consideration was furnished by Minnie Kanter who had absolutely no reserved powers or control over trust corpus or income. The appellants furnished no *quid pro quo* for the transfers in trust and had no control over the selection of the fiduciaries. There is thus no reason in law or fact to transpose their positions.

(c) There Is No Evidence of the Exercise of Control on the Part of the Appellants, and No Inference Arises That, Because of the Relationship of the Trustees and Appellants, the Trustees Are Amenable to the Appellants.

The third principle reason expressed for the District Court's general Findings and Conclusions that the appellants controlled the trust income and corpus is the relationship existing between the trustees and appellants as beneficiaries. This reasoning requires as a corollary a premise that, even in the absence of evidence to support such conclusion, such relationship *ipso facto* indicates amenability and control.

While in some instances the family relationship of a trustee and beneficiary, even though present, has not even been alluded to in opinions concluding that there was no evidence of control on the part of a trust beneficiary (*e. g.*, *Hallowell v. Commissioner of Internal Revenue*, 160 F. 2d 536 (3rd Cir., 1947), where the beneficiary was the wife and the trustee was the son of the grantor), in other instances the courts have squarely met similar contentions on the part of the Commissioner.

In *Estate of Frederick S. Fish*, 45 B. T. A. 120 (1941) (Acq.), decedent created a trust for the benefit of his wife for life, remainder to his children. Decedent had an *inter vivos* power to terminate the trust with the consent of his wife. The trust was not terminated prior to decedent's death. The Commissioner contended that the *power* to terminate required the inclusion in decedent's gross estate of the value of the trust corpus. On page 123, the court answered this contention as follows:

“He (Commissioner) says first that under the concept of family solidarity and in view of the wife's other interests, it cannot be assumed that she would

fail to comply with a request by decedent. Such a doctrine would proceed further than seems warranted by any principle so far established. Even under such decisions as *Helvering v. Clifford*, 309 U. S. 331, the concept of family unity is an economic consideration rather than one of conduct or behavior. The inclusion in the husband's income of that derived from a trust of which members of his family are the beneficiaries results more from the view that family finances are a single unit generally furnished by the husband or father than that the action of individual members of the family group will necessarily accord with the dictates of its head." (Reference added.)

Note also *Commissioner of Internal Revenue v. Goodan*, 195 F. 2d 498 (9th Cir., 1952).

A similar situation existed in the case of *Lillian M. Newman*, 1 T. C. 921 (1943). In this case, petitioner set up two trusts for the primary benefit of her two minor children, with her husband as a remainderman. Petitioner's husband was also the trustee. As trustee, petitioner's husband had the power to revoke the trust in whole or in part whereupon all the trust property would be turned over to petitioner. The Commissioner sought to tax petitioner under numerous theories. In discussing the taxability of petitioner under Section 166 of the Internal Revenue Code of 1939, the court said, at page 924:

"Our view was, and is, that the *Clifford* case does not mean that a person with an otherwise adverse interest will, solely by reason of marital relationship, act in accordance with the wishes of his or her spouse."

It is noted in the *Fish* and *Newman* cases that the conclusions that the trustee was not considered amenable to the beneficiary despite the close family relationship in-

volved was apparently influenced by the fact that the trustee was considered to have an interest adverse to that of the beneficiary. In this connection it should be further noted that the trustees in the instant cases are also “secondary beneficiaries” of the trusts of which they are fiduciaries, possessing interests contingent on the death of the primary beneficiary before January 2, 1960, without lawful issue or a lawful spouse surviving. [R. 32, 51.]

That the “secondary” interests of the trustees in the instant matters are “substantially adverse” to that of the primary beneficiaries, is illustrated by the case of *Meyer Katz*, 46 B. T. A. 187 (1942). In the *Katz* case petitioner created trusts primarily for the benefit of each of his three children with his wife as a contingent beneficiary. During the taxable year in question the trust could be terminated and part of the property revert to petitioner by delivery to the trustee of a written instrument directing such termination, executed jointly by petitioner and his wife. In holding that petitioner did not retain control over the corpus and was therefore not taxable under either the *Clifford* decision or Section 166 of the Internal Revenue Code of 1939, the court said, at page 194:

“The petitioner’s wife Helen was a living, definitely ascertained person who had the fixed right, in the event a primary beneficiary predeceased her without leaving issue, to have a substantial share of the trust income that might be currently distributed and of the entire trust estate, including accumulated income, distributed to her. Also, in our opinion, such contingent interest of the wife was a ‘substantial adverse interest’ to the grantor, petitioner, within the meaning of Section 166, *supra*.” (Citations omitted.)

The relevancy and interplay of Sections 166 and 167 (Appendix) with the doctrines of the *Clifford* and *Mal-*

linckrodt cases is indicated in the *Lillian M. Newman* case at page 925 of 1 T. C. where the Tax Court stated:

“The *Clifford* case is cited only in connection with Section 166, as indicated above. Nevertheless, we deem it appropriate to express our conclusion that the petitioner is not taxable upon the trust income by virtue of Section 22(a). We have here long-term trusts with no control whatever reserved to the grantor. She did not remain the substantial owner of the trust fund. The fact that her husband was named trustee does not by itself require that the grantor be taxed. ‘It is natural that the grantor of the trust will appoint as fiduciaries persons upon whose ability and integrity he may rely.’ (Citation omitted.) In this case there is not only *a lack of evidence that petitioner could exercise control by dominating her husband*, but there is in fact testimony to the contrary. We hold that petitioner is not taxable under Section 22(a).” (Italics added.)

The *Fish*, *Newman* and *Katz* cases are thus authority for the premise that, even if the appellants in the instant proceedings were given *express* power in the trust instruments to convert either trust corpus or income thereof to themselves with the concurrence of the trustees, the broad implications of Section 22(a) would still not require attribution of the trust corpus or income to them. Lacking such express power, the instant cases present even weaker examples of control on the part of the appellants.

A more recent example of a situation factually stronger than the instant cases on the question of control on the part of a trust beneficiary is *Smither v. United States*, 108 Fed. Supp. 772 (S. D. Tex., 1952), affirmed in 205 F. 2d 518 (5th Cir., 1953). It could scarcely be denied that if, in the instant cases, the primary beneficiary of each trust

were also the sole trustee thereof, the contention of the Government and the conclusion of the District Court that the appellants had unlimited control over the trust property would be strengthened. The Government would then be in a position to argue that, as sole trustee, the beneficiary could distribute accumulated income to himself without limitation, under the fifth paragraph of the trust instrument, by virtue of the *Merchants National Bank of Boston v. Commissioner* decision, 320 U. S. 256, 64 S. Ct. 108 (1943); this case held that power to invade the corpus of a trust for "comfort, support, maintenance, and/or happiness of my wife" was not a standard capable of being stated in any definite terms of money. This holding related to a determination that income of a trust was taxable to the beneficiary to the extent to which income could have been diverted because of the uncertainty of this standard.

This very proposition was before the court in the *Smither* case. In the *Smither* case, for the years in question, 1944 and 1945, taxpayer was at once the trustee and primary beneficiary of a trust. The "fiduciary" of this trust was empowered to expend such part of the income and to invade the corpus of said estate for the support, maintenance, comfort and pleasure of Mrs. Smither (taxpayer) and of the children as in the discretion of the fiduciary "may appear to be proper or desirable." *No income was withdrawn by the trustee during any of the years in question.* The Commissioner had maintained that

" . . . Mrs. Smither, as sole trustee during the years in question, had unlimited discretion to expend all or any part of the income for her own purposes, and hence the income should be taxable to her under *Corliss v. Bowers* . . . *Mallinckrodt v. Newman* . . . *Grant v. Commissioner* . . . and similar cases."

In holding that the income of the trust for the taxable years in question was not taxable to the taxpayer under Section 22(a) of the Internal Revenue Code of 1939, the Court stated, on page 774,

“As sole surviving trustee, her use of the trust income remained subject not only to a compelling moral obligation to carry out the expressed desires of her deceased husband, but to a legal obligation as well, namely, that no more be withdrawn for her own purposes than was necessary for her support, maintenance, comfort and enjoyment, with a similar right in her children. In my opinion, this standard as set out in the will was sufficiently clear and definite to be both understandable and enforceable. When read in connection with other provisions of the will, and viewed in the light of the testator’s circumstances, it means no more than that the needs of maintaining the family in the station of life to which it had become accustomed should be met . . .

“The defendant urges *Merchants National Bank v. Commissioner*, 321 U. S. 256 . . . upon me as compelling a contrary result. It is true that the purposes for which the trust income might be utilized, or the corpus invaded, under terms of the trust there in question (‘for the “comfort, support maintenance and/or happiness of my (said) wife”’) are very similar to those before me. But the question presented to the court there was entirely different . . . I do not consider such authority in point on the question before me.”

Certainly the *Smither* case presented a stronger position for the Commissioner than did the facts of the cases with which we are presently concerned.

In the instant cases there is no evidence to indicate that the trustees are amenable to the beneficiaries; there is no inference of control because of the family relationship. In fact, the contingent interests of the trustees in the trust estates provide an inference to the contrary. Further, by virtue of the *Fish*, *Newman*, *Katz* and *Smither* cases it is doubtful that the income of the trust estates for the years in question could be attributed to the primary beneficiaries even if they had certain limited *express* power over the trust property.

In final analysis, the importance of the trustee-beneficiary relationship in the instant matters is questionable in light of the explicit language of Treasury Regulation 111, Section 22(a)-22 (Appendix). This regulation, controlling for the last two taxable years involved in these proceedings, provides in part that,

“Where a person other than the grantor of property transferred in trust has a power exercisable *solely by himself* to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person.” (Italics added.)

Regulation 111, Section 22(a)-22 was enacted into statutory law as Section 678 of the Internal Revenue Code of 1954. In connection with Section 678, (Appendix) the editors of the American Law Institute, February, 1954, Draft of the 1954 Internal Revenue Statute state,

“Thus a person is taxable under sub-sections (a) (1) and (2) only if a power is exercisable solely by himself. If a power is exercisable by a party who is related or subordinate to such person, the section will not apply.”

The editors explained this administrative attitude as follows :

“The basis of the requirement may be that a related or subordinate party is not always as fully controlled by such person as he would be by a grantor to whom he was similarly related or subordinate.”

The appellants were given no express control over trust income or trust corpus; the appellants have not exercised any control over trust income or corpus. If the explicit language of Treasury Regulation 111, Section 22(a)-22, has any meaning whatever it would be immaterial even if appellants *were* given a measure of express power to be exercised with the concurrence of the Co-Trustees. As stated heretofore in connection with the significance of the *Fish*, *Newman*, and *Katz* cases, lacking such power, the instant cases present even weaker examples of control on the part of the appellants.

4.

Since Substantial and Irrevocable Gifts Were Effected Through the Trust Medium; the Absence of a Business Purpose and the Presence of Tax Savings Motives Does Not Render Invalid the Trusts Created Thereby.

The District Court has concluded that the trusts in question were invalid because of the absence of a business purpose and the presence of tax reduction motives in setting up the trusts.

It cannot be denied that where the issue before the court is a recognition of a corporate reorganization, *Gregory v. Helvering*, 293 U. S. 465, 55 S. Ct. 266 (1935), or of a one-man corporation as a separate entity, *Higgins v. Smith*, 308 U. S. 473, 60 S. Ct. 355 (1940), or of a sale

and leaseback arrangement, *Shaffer Terminals, Inc.*, 16 T. C. 356 (1951), affirmed 194 F. 2d 539 (9th Cir., 1952), the existence of an independent business purpose for certain transactions may be very important. However, existence of a business purpose in creating a trust is not only not required by the revenue statutes or any cases but, in fact, should be singularly avoided lest the trust be held taxable as a corporation. In *Main-Hammond Land Trust v. Commissioner of Internal Revenue*, 200 F. 2d 308 (6th Cir., 1952), the Court states on page 311,

“The essential distinctions between the ordinary trust and a trust which is an association and thus, under Section 3797, I. R. C., taxable as a corporation, have been described by the Supreme Court in *Morrissey v. Commissioner*, 296 U. S. 344 . . .”

In determining if a trust should be taxable as a true trust or held to be taxable as a corporation, the Court continued,

“The crucial question is whether the trust was organized for a business purpose. In solving this question the underlying purpose for the creation of the trust must be considered.”

In connection with the necessity of a business purpose consideration should be accorded the case of *W. P. Hobby*, 2 T. C. 980 (1943). In this case, in four instances preferred shares owned by the taxpayer were soon to be redeemed at par by the corporation, as the taxpayer expected, and he sold them in one instance to a friend for a price less than par so that the gain would be realized as a gain from a sale taxable as a long-term capital gain, and in three instances for par, after which the purchaser would receive a dividend. When the shares were redeemed, the taxpayer had sold them and was not the owner, and the purchasers received the redemption price from the cor-

poration. In holding that the gain of the taxpayer was taxable as a long-term capital gain from sale taxable under then Section 117 and not a short-term gain from liquidation and redemption, taxable under then Section 115, the Court said, on page 985,

“The Commissioner argues that petitioner did not in fact sell, or may not be regarded as having sold, the shares. He says that this is because the alleged sale ‘had no business purpose’. What kind of ‘business purpose’ must be shown as necessary to the recognition of a sale is not made clear, and there is no statutory requirement to that effect. . . . Petitioner, a shareholder, had an unrealized increment in his shares which he wanted to realize. Collaterally he wanted to use a legitimate transaction which would impose upon him the least tax. This is not an interdicted purpose. The primary purpose to realize the gain was a legitimate business purpose even though it also had a collateral favorable tax effect . . . The petitioner’s tax saving purpose did not invalidate the sale.”

The above quoted language was cited by the court in *Sun Properties v. United States*, 220 F. 2d 171 (5th Cir., 1955), where the court also strongly demonstrated the immateriality of tax savings motives when it paraphrased the United States Supreme Court on page 174, stating,

“. . . the Supreme Court said that a motive of tax avoidance will not establish liability if the transaction does not do so without it. It may fairly be said that a tax avoidance motive must not be considered as evidence that a transaction is something different from what it purports to be . . .

“Legal transactions cannot be upset merely because parties have entered into them for purpose of minimizing or avoiding taxes which might otherwise accrue. (Citations omitted.)

“Nor does the fact that this transaction may not have had any business purpose other than saving taxes, rationally imply that it was not a sale.”

Factually more in point is the case of *J. M. Walsh*, 18 B. T. A. 571 (1929). In this case taxpayers each owned own-half of the shares of the total outstanding stock of a corporation. The stock had a low basis in the hands of taxpayers. Taxpayers had received several good offers for the stock which they declined because of the large taxes; taxpayers then made a gift of three-fourths of their respective stock interests, in trust, to themselves as trustees, for the benefit of their respective families. The stock interests were sold and taxpayers reported profits on $12\frac{1}{2}$ shares of stock ($\frac{1}{4}$ of their prior holdings). The Commissioner sought to tax taxpayers on all of the profits (100% of their prior holdings). On page 576 the Court, in holding that taxpayers were taxable only on $12\frac{1}{2}$ shares, stated,

“Relying upon the advice of an attorney, and for the admitted purpose of avoiding the payment of a large tax and with the intent to make absolute and irrevocable gifts, petitioners executed . . . the trust instruments set forth in the findings of fact . . . The courts have also held that a device to avoid or minimize the burden of the revenue acts may be resorted to if effectuated by legal means. (Citations omitted).”

In the cases with which we are presently concerned the existence of tax-savings motives on the part of Minnie

Kanter in employing trusts in effectively and irrevocably making gifts does not render the trusts invalid; the existence of a "business purpose" in creating the trusts would have been fatal to this admitted and valid purpose in employing the trusts in the first place and might bring the trusts under the doctrine of business trusts taxable as corporations. Further, it should be emphasized that, while Minnie Kanter's sole purpose in *employing* trusts was to reduce the income taxes that her children would have to pay, her choice of the *means* of conveyance was only incidental to her primary desire—to make gifts to her children and the potential issue of her children.

Unlike *Helvering v. Clifford* wherein, as concerned the relinquishment of dominion and control, "the trust did not effect any substantial change," 309 U. S. 331 at 335, Minnie Kanter irrevocably transferred all dominion, control, and economic benefit of the trust corpus and income. Gift taxes were paid on the transfers and a later deficiency based on the ground that "future interests" only were transferred to the beneficiaries was assessed and paid. As stated in the case of *Lura H. Morgan*, 2 T. C. 510 at page 515 (1943),

"So long as the gift is valid and real a motive to reduce taxes becomes immaterial."

5.

Conclusion.

Since the Revenue Act of 1916, the history of trust taxation reveals a pattern of active administrative and congressional modification and refinement of principles designed to provide adequate guide posts for courts, taxpayers, and government agents to follow. Following the *Clifford* decision and the chaos and uncertainty left in its

wake, the Treasury Department published its regulations providing the "more precise standards or guides" suggested by the *Clifford* decision. These regulations were adopted almost verbatim in the Internal Revenue Code of 1954 in Sections 671 to 678, thus indicating congressional approval of the *status quo*.

The provisions of these statutes are very explicit and, according to Section 671 are intended to be exclusive. Section 671 provides in part as follows:

"No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under Section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart."

Thus, the door was completely closed to any attempt on the part of the government to tax trust income to a grantor or other person under the general section defining gross income—Section 61, the former Section 22(a). The accompanying Senate Committee Report makes it clear that this is, in fact, the intent of the new law. The Senate Finance Committee report, S. Rept. 1622, 83rd Congress, 2nd Session, at page 365, states:

"The effect of this provision (Section 671) is to insure that taxability of *Clifford* type trusts shall be governed solely by this subpart."

Much of existing case law had been based upon the Treasury Regulations discussed heretofore which have been accorded legislative approval by enactment into statutory

law. These decisions have firmly established that, unless a person is given *express* power pursuant to the trust instrument to deal with trust corpus or income in a manner consistent with ownership, or there is *substantial evidence* demonstrating an *actual* dealing with trust corpus or income in such a manner, income shall not be attributed to such person. In its Findings and Conclusions the District Court ignores these standards and provides, in essence, that even lacking the existence of *express power* or evidence of *actual power* exercised to obtain income, a person should nonetheless pay income tax if there is a possibility that he might have obtained income.

In so concluding, the District Court pays no heed to the legislative intent expressed in Section 671 of the Internal Revenue Code of 1954 and the accompanying Committee Reports, obliterates what standards have heretofore been provided by case law and Treasury Regulations, and takes a long step toward restoring the chaos which existed in the era immediately following the *Clifford* decision. *No case heretofore has gone so far.*

In discussing the effect of Section 22(a) of the Internal Revenue Code of 1939, as applied to beneficiaries and third persons, in Mertens, *Law of Federal Income Taxation*, Volume 6, Section 3724, page 551 (1948 revised volume), it is stated,

“ . . . It is noteworthy that in most of the instances wherein a beneficiary or third person has been held taxable with trust income under Section 22(a), as in substance the owner thereof, the degree of such

person's control over the trust has been clear and extensive. If less than that, such a result cannot justifiably be reached."

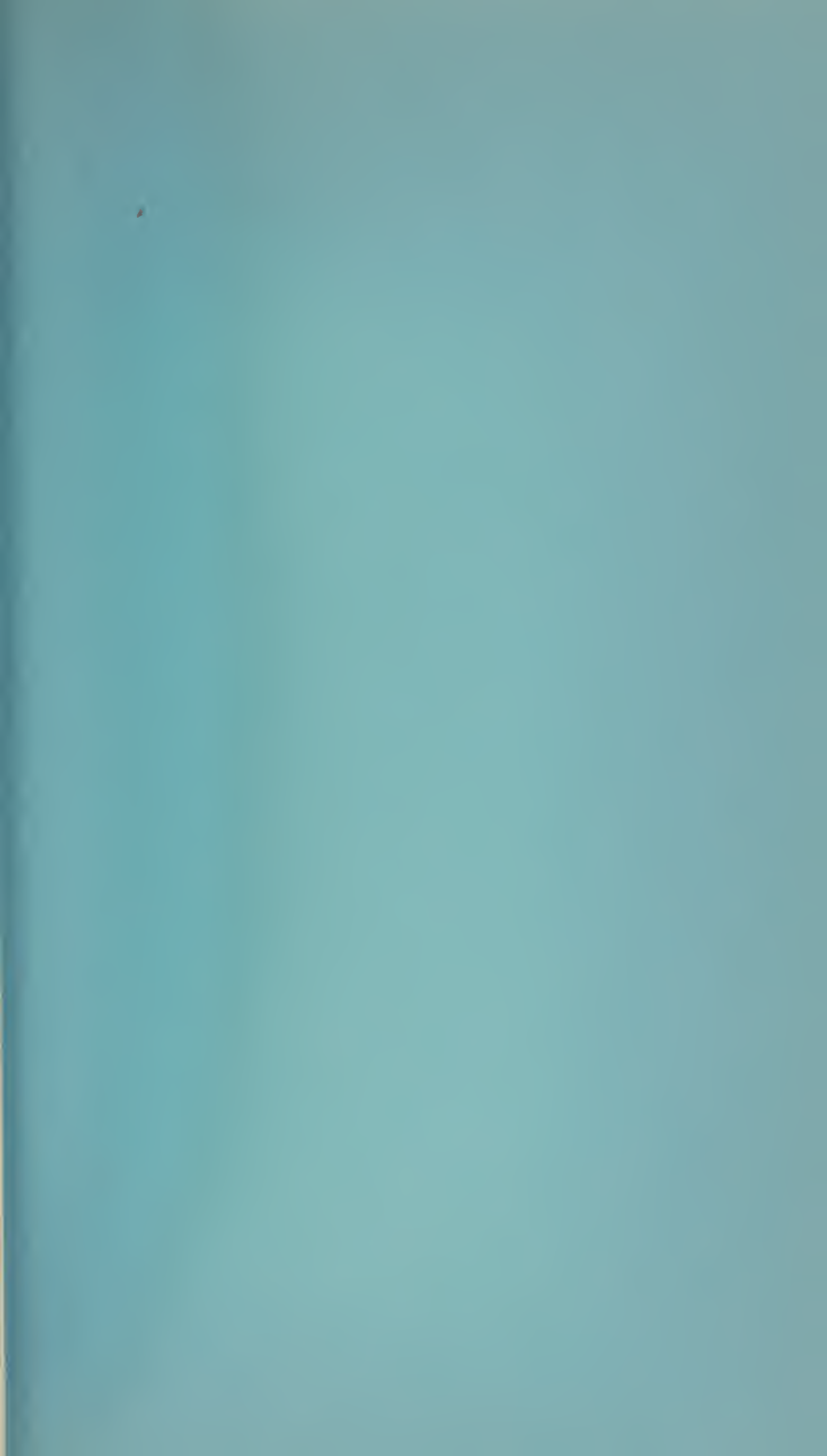
For the reasons and upon the grounds hereinabove set forth, appellants respectfully urge the Court to reverse the judgments of the Court below and to order judgment for appellants.

Respectfully submitted,

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APPENDIX.

I. Internal Revenue Code of 1939.

Section 22(a):

“General Definition.—‘Gross income’ includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.”

Section 166:

“Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.”

Section 167:

“(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23(o), relating to the so-called “charitable contribution” deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term “in the discretion of the grantor” means “in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question.”

(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor."

II. Internal Revenue Code of 1954.

Section 671:

"Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart."

Section 678:

“(a) General Rule.—A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(b) Exception Where Grantor Is Taxable.—Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under sections 671 to 677, inclusive.

(c) Obligations of Support.—Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or co-trustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661 (a) and shall be taxed to the holder of the power under section 662.

(d) Effect of Renunciation or Disclaimer.—Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.”

III. Treasury Regulations.

“Reg. 111, Sec. 29.22(a)-22. Trust Income Taxable to Person Other Than Grantor.—Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person. Even though such a power has been partially released or otherwise modified so that the person holding it can no longer vest the corpus or the income of the trust in himself, the income shall continue to be taxable to such person if, after such release or modification, he has retained such control of the trust as would, within the principles of section 29.22(a)-21, subject a grantor of such a trust to tax on the income thereof. This section shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor is otherwise taxable under section 29.22(a)-21. See also Section 29.166-2.

“Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.”

Nos. 15757, 15758, 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeals From the Judgments of the United States
District Court for the Southern District of California.

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Nos. 15757, 15758, 15759

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 15757

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

No. 15758

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

No. 15759

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeals From the Judgments of the United States
District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

Opinion Below.

The findings of fact and conclusions of law of the
District Court [R. 29-44] are not officially reported.

Jurisdiction.

These appeals¹ involve federal income taxes. The Commissioner of Internal Revenue determined deficiencies in income tax in years and amounts as follows [R. 36]:

	<u>1945</u>	<u>1946</u>	<u>1947</u>
Laurence V. Kanter	\$ 803.72	\$3,488.64	\$5,492.62
Jerome B. Kanter	375.32	2,461.23	3,624.74
Ruth Kanter Wolins	1,129.30	4,482.70	8,278.77

These amounts were paid by the respective taxpayers and on or about August 12, 1950, timely claims for refund were filed seeking refund of a portion of the above deficiencies plus interest in the following amounts [R. 36]:

	<u>1945</u>	<u>1946</u>	<u>1947</u>
Laurence V. Kanter	\$ 794.05	\$3,302.73	\$4,553.55
Jerome B. Kanter	375.32	1,956.41	2,751.18
Ruth Kanter Wolins	869.20	3,567.13	5,346.20

These claims were either formally disallowed by the Commissioner or no action was taken by the Commissioner for six months. [R. 9-10, 12, 15.]

Thereafter within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on April 3, 1953, taxpayers brought actions in the District Court for the Southern District of California for recovery of taxes paid in the amounts stated in the refund claims. [R. 3-12.] Jurisdiction was conferred on the District

¹Because of the identity of factual and legal issues the three cases have been consolidated on appeal and only the record in *Laurence V. Kanter v. United States* (No. 15757) has been printed with leave reserved to refer to the certified record in the other two cases on brief and argument. [R. 87-90.]

Court by 28 U. S. C., Section 1346. The judgments were entered on July 29, 1957. [R. 45.] Within sixty days and on September 19, 1957, notices of appeal were filed. [R. 46.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether the District Court erred in finding that the income of three trusts of which taxpayers were beneficiaries was properly included in taxpayers' gross income for the taxable years involved, such trusts, lacking in substance and reality, having been created solely as a tax minimization device?

Statute and Regulations Involved.

The pertinent sections of the applicable statute and Regulations are set forth in Appendix, *infra*.

Statement.

The basic facts as found by the District Court [R. 30-43] were either stipulated by the parties [R. 17-27, 73-75, 76-81] or are based on exhibits introduced in evidence. [R. 47-81.] They are summarized below.

During the early part of 1944 the Kanter family consisted of Harry L. Kanter, his wife, Minnie Kanter, and their three adult children, taxpayers Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins. The family operated a chain retail food and liquor business under the name of Shop 'N Save, a California corporation. The three children each owned 6.81% of the stock; the father owned 13.31% and the mother owned the remaining 66.26%. [R. 31.]

During the early part of 1944, the stockholders agreed to terminate the corporation and form a limited partnership to conduct the identical business then being conducted in corporate form. At the same time the mother, Minnie Kanter, decided to make a gift of a portion of her interest in the business to each of her children (taxpayers). In order to reduce the taxes that her children would have to pay on the proposed gift, Minnie Kanter conveyed a 6.81% interest in the family business in trust for each child. In all respects as to Minnie Kanter the gifts were valid since she effectively parted with control and paid a gift tax on the transfers. [R. 31.]

The three trusts are referred to throughout in terms of the chief beneficiary. Under each trust instrument there were at least two secondary beneficiaries who had an interest contingent on the death of the primary beneficiary before January 2, 1960, without lawful issue or spouse surviving. The trustees, their relationship to the beneficiary and the secondary beneficiary of each trust are as follows [R. 32]:

<u>Trustees</u>	<u>Secondary Beneficiaries</u>
<u>Laurence V. Kanter Trust</u>	
Ruth Kanter Wolins (sister)	Jerome B. Kanter
Albert Wolins (brother-in-law)	Ruth Kanter Wolins
<u>Jerome B. Kanter Trust</u>	
Ruth Kanter Wolins (sister)	Ruth Kanter Wolins
Laurence V. Kanter (brother)	Laurence V. Kanter
<u>Ruth Kanter Wolins Trust</u>	
Albert Wolins (husband)	Albert Wolins if sur-
Laurence V. Kanter (brother)	viving; otherwise,
	Laurence V. Kanter
	Jerome B. Kanter

Although not referred to in the findings of fact it appears that taxpayer Jerome B. Kanter was in the armed forces when the trusts were created. [Ex. 1-E, R. 70.]

On or about April 1, 1944, the corporation, Shop 'N Save, was partially liquidated and a limited partnership under the name of Kanter & Wolins was organized to conduct the same business. This had been in contemplation prior to the execution of the trusts. On the partial liquidation the shares of capital stock held by the shareholders were cancelled in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. The shares of capital stock which were to have been placed in the corpus of each trust executed by Minnie Kanter were thus cancelled and the value of the corpus of each trust was credited to the capital account of each trust on the books of the partnership. No separate books were kept for the trusts and transactions affecting the trusts were reflected only in the capital accounts of the trusts as limited partners on the books of the partnership. [R. 32-33.]

Pursuant to the agreement of limited partnership entered into on March 31, 1944 [R. 64-71], a Certificate of Limited Partnership [R. 58-63] was executed and filed with the Los Angeles County Recorder on April 1, 1944. The general and limited partners, their capital investments and percentage ownership are as follows [R. 34]:

	Capital Investment	Per Cent of Capital and Profits
<u>General Partners</u>		
Harry L. Kanter	\$ 31,058.00	13.31%
Laurence V. Kanter	15,910.00	6.81%
Albert L. Wolins	10,600.00	4.54%
<u>Limited Partners</u>		
Minnie F. Kanter	105,894.00	45.37%
Jerome B. Kanter	15,900.00	6.81%
Ruth Wolins	5,300.00	2.27%
Trust No. 1 (for Jerome B. Kanter)	15,900.00	6.81%
Trust No. 2 (for Laurence V. Kanter)	15,900.00	6.81%
Trust No. 3 (for Ruth Wolins)	15,900.00	6.81%
Trust No. 4 (for Sue Ellen Wolins)	1,060.00	.46%

The capital investment of each partner consisted of his stock in Shop 'N Save. Although there was no restriction on the right of a general partner to assign all or a portion of his interest in the partnership, the agreement expressly prohibited assignment of the interest of a limited partner. [R. 34-35.]

The trust instruments in question gave broad powers of investment and management of the corpus to the trustee. The term of each trust was 15 years and 10 months divided into three periods, A, B and C, ending on January 2, 1950, 1955 and 1960, respectively. The accumulated income of each trust was to be distributed at the end of periods A and B, and all accumulations and

the corpus to be distributed at the end of period C, the terminal date of the trusts. [R. 37-38.]

The trustees had discretion to distribute income to the beneficiary at any time as follows [R. 38]:

In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.

Between April 1, 1944, and January 2, 1950, the end of period A, the captial account of each trust in the books of the partnership increased from \$15,900 to over \$43,-000 by reason of the crediting of annual partnership income thereto. Despite the express provision of the trust instruments, this income of the trusts was not distributed on January 2, 1950, but was retained in the partnership. [R. 38-39; 42-43.]

On January 9, 1950, the partnership exchanged substantially all of its assets for all the common stock in a newly-formed corporation, McDaniel's Markets. Despite the fact that this corporation consistently lost money and subordinated the common stock by obtaining outside capital through issuing preferred stock, the trustees permitted the corpus to remain invested in that business. [R. 39-43.]

The Commissioner of Internal Revenue determined that the income of the trusts for the years 1945, 1946 and 1947 was properly taxable to the chief beneficiary of each trust and asserted deficiencies in tax on that theory. After payment of the deficiencies and rejection of their

refund claims taxpayers brought the present suits for the refund of the portion of the deficiencies caused by the inclusion of trust income in their individual incomes. [R. 36.]

The District Court approved the Commissioner's determination and concluded that the creation of the trusts was solely a tax minimization device lacking substance and reality and that the Commissioner was correct in including trust income in the taxable income of taxpayers. [R. 42, 44.]

Summary of Argument.

It is the Government's contention that the trusts in question when viewed in light of all the surrounding circumstances were correctly found to be illusory. The facts disclose that while the grantor made a valid gift to each taxpayer of a share of the family business, the form of the gifts, in trust, was intended from the outset to have validity for tax purposes only. This is demonstrated by the unique business and familial interrelationships of the trustees and beneficiaries and the fact that the trusts were never regarded as anything more than a tax minimization device by the parties directly involved. Further, subsequent events prove this beyond any doubt since the fiduciary duties and mandatory directions of the trust instruments were totally ignored.

The applicable decisions make it clear that when a beneficiary of a trust can receive any or all of the trust income at his own option, he is taxable on the entire income whether distributed or not. The income is thus taxable to the taxpayers under the mandate of Section 22(a) of the Internal Revenue Code of 1939.

ARGUMENT.

The Decision of the District Court That the Trusts in Question Were Illusory and Should Be Disregarded for Income Tax Purposes Was Correct and Should Be Affirmed.

The issue in these cases is whether the District Court erred in finding that the taxpayers were taxable on the undistributed income of three trusts of which they were the beneficiaries. There appears to be little dispute as to the applicable rule of law, the taxpayers on brief summarizing it as follows (p. 23):

Where income is subject to one's unfettered command during the taxable year and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not.

To this proposition we can only add that in determining whether the facts of a particular case meets this rule the courts are not limited by form or "the legal paraphernalia which inventive genius may construct", but judge the actual bona fides of the transaction giving "special scrutiny" where intra-family arrangements are involved. *Helvering v. Clifford*, 309 U. S. 331, 333; *Corliss v. Bowers*, 281 U. S. 376; *Helvering v. Horst*, 311 U. S. 112; *Helvering v. Eubank*, 311 U. S. 122; *Lucas v. Earl*, 281 U. S. 111; *Trousdale v. Commissioner*, 219 F. 2d 563 (C. A. 9th). Such income is includible in gross income under the provisions of Section 22(a) of the Internal Revenue Code of 1939, Appendix, *infra*.

The disagreement in this case would thus seem to be limited to the question of whether the trust income under consideration was actually subject to taxpayers' unfettered command as the District Court concluded. [R. 44.] This presents a question of fact for the trier to be resolved

by reference to all the surrounding circumstances. *Helvering v. Clifford*, *supra*; *Helvering v. Elias*, 122 F. 2d 171 (C. A. 2d); *Paster v. Commissioner*, 245 F. 2d 381 (C. A. 8th), certiorari denied, 355 U. S. 876. The findings of the District Court should not be disturbed unless clearly erroneous. Rule 52(a), Federal Rules of Civil Procedure. Nor does the fact that the cases were submitted on stipulated facts and exhibits justify *de novo* consideration as taxpayers suggest. (Br. 21.) In such cases this Court has said that “the ultimate question is whether the findings are supported by the record” and that “findings of fact shall not be set aside unless clearly erroneous.” *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263, 265, distinguishing *Pacific Portland Cement Co. v. Food Mach. & Cham. Corp.*, 178 F. 2d 541 (C. A. 9th), relied on by taxpayers. (Br. 21.) See also, *United States v. Gypsum Co.*, 333 U. S. 364, 394-395, rehearing denied, 333 U. S. 869; *Randall Foundation, Inc. v. Riddell*, 244 F. 2d 803, 805 (C. A. 9th); *Stockton Harbor Indus. Co. v. Commissioner*, 182 F. 2d 1010, 1013-1014 (C. A. 9th).

The District Court found that the creation of the trusts was a “tax minimization device” under which the “beneficiaries of the trusts had unlimited power and control over the corpus of the trusts” [R. 42], and concluded that the beneficiaries were the actual owners of the trust income. [R. 44.] It is submitted that there is ample support in the record for such findings.

At the outset it should be noted that tax avoidance was the only purpose and function of these trusts. Taxpayers have stipulated [R. 74] that the settlor’s “*sole purpose* in executing these trusts * * * was to reduce the taxes that her children would have to pay on the income from

the property gifted by her.” (Emphasis supplied.) While this fact alone is admittedly not determinative, it is certainly a pertinent part of total background and should not be ignored so as to “exalt artifice above reality.” *Gregory v. Helvering*, 293 U. S. 465, 467. The obvious result of allowing the trusts to stand would be to recognize the existence of six taxpayers where only three would exist if the gifts were made outright. The resulting diffusion of income was apparently the only motive of the conveyance into trust.

The conceded tax avoidance motive does become important when combined with the reciprocal nature of the trusts and the business and familial relations of the parties. When Minnie Kanter, the grantor, established the trusts in 1944, the family business was operated as a corporation and was wholly owned by the Kanter family, with each taxpayer owning 6.81%, the father, Harry, owning 13.31%, and the mother, Minnie, owning the remaining 66.26%. [R. 31.] Minnie decided to give each child another 6.81% interest in the business and at the same time the form of doing business was to be changed from a corporation to a limited partnership. [R. 31.] If the trust arrangement had not been used, there is no question that the taxpayers each would have had to report 13.62% of the distributable partnership income whether received or not. Section 182, Internal Revenue Code of 1939, as amended by Section 150(g)(1)(B) of the Internal Revenue Act of 1942, c. 619, 56 Stat. 798. However, under the trust arrangement, if valid, each child would have to report as income from the trust only the amount that he actually received. Sections 161(a) and 162(c) of the Internal Revenue Code of 1939. (Appendix, *infra*.)

The obvious inference from the very recitation of the facts is that each beneficiary was to get whatever portion of trust income he or she wanted. There is no other explanation for the curious interrelationship of beneficiaries and trustees—*i.e.*, Laurence was at once trustee for his brother's and sister's trust and beneficiary of a trust administered by his sister and her husband; his sister, Ruth, was trustee for Laurence and Jerome and beneficiary of a trust administered by her husband and Laurence; Jerome was not a trustee, apparently because he was absent in the armed forces [R. 70], but his trust was exactly like the others and was administered by his brother and sister. [R. 32.]

Each trustee was empowered to distribute income as follows [R. 38]:

In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.

Thus, a trustee in the exercise of his "discretion" in paying out income could do so only with the proposition firmly fixed in his mind that if he ever wanted anything from his trust, he must apply to the beneficiary whose request was under consideration.² Nor is it possible that

²In this connection it is submitted that taxpayers are in error in arguing (Br. 34) that as secondary beneficiaries of the trusts the family members when acting as trustees would have an interest adverse to that of the chief beneficiaries. There is nothing in the record to show that this secondary interest would overcome a trustee's primary interest as chief beneficiary of one of the reciprocal trusts.

there would be much difficulty under the circumstances in convincing a trustee that one needed the distribution for his proper "support, maintenance, comfort, education and recreation." (Emphasis supplied.) Cf. *Merchants Bank v. Commissioner*, 320 U. S. 256.

Moreover,¹ after the limited partnership had replaced the wholly owned corporation as the family method of doing business, each trust was made a limited partner under an agreement expressly making the interests of limited partner non-assignable. [R. 34-35; Ex. 1-E, R. 69.] Consequently, although the trustees of the various trusts had unlimited power of investment [R. 37], the corpus was immediately and according to a pre-arranged plan [R. 32-33], inextricably invested in the family business, adding to the cumulative inference that the "trustees" were never intended to be fiduciaries at all. Additionally it is also worthy of note that no separate books were kept for the trusts by the "fiduciaries," all trust transactions being reflected only on the books of the family partnership. [R. 33.]

The scheme was obviously one with a built in guarantee that each beneficiary could either receive the income or allow it to accumulate and be required to pay taxes only on the amount actually received. It is submitted that the scheme itself was so transparent a form of tax avoidance that the District Court would have been justified in holding the trust illusory without more.

The inference that the trusts were intended to have validity only for tax purposes is unmistakable. However, this conclusion need not rest solely on logical inference and reasonable assumption for subsequent events proved

it conclusively. The trust instrument provided that accumulated income for period A (March 3, 1944, to January 2, 1950) "shall be distributed to the beneficiary hereof on the 2nd day of January, 1950." [R. 37.] Despite this express direction, the trust income was never distributed but was retained in the partnership. [R. 39.] Moreover, even after the partnership exchanged its assets for stock in a newly formed corporation and the corporation consistently lost money and subordinated its common stock to preferred, the trustees made no move to withdraw the trust funds. [R. 43.] The trustees neither exercised any independent fiduciary judgment nor did they even follow the express directions of the trust instrument.³

Contrary to taxpayer's suggestion (Br. 45), the District Court has not departed from established precedent in this case. As we have indicated it is well settled that a beneficiary of a trust who has the right to receive income from the trust in the amounts and at the times he desires is taxable with the trust income whether it is actually distributed or not. *Grant v. Commissioner*, 174 F. 2d 891 (C. A. 5th); *Bunting v. Commissioner*, 164 F. 2d 443 (C. A. 6th); *Emery v. Commissioner*, 156 F. 2d 728 (C. A. 1st), certiorari denied, 329 U. S. 882; *Stix v. Commissioner*, 152 F. 2d 562 (C. A. 2d); *Mallinckrodt v. Nunan*, 146 F. 2d 1 (C. A. 8th), certiorari denied, 324 U. S. 871; and *Frank v. Commissioner*, 145 F. 2d 413 (C. A. 3d); Treasury Regulations 111, Section

³Taxpayers' objection (Br. 14) to the materiality of this evidence is not well founded. While the subsequent facts may not prove that there was a right to receive income in the years in question here it is clear that they establish that the inference that there was in fact no bona fide trusts is correct. These facts merely serve to check on and confirm the correctness of this inference—a safeguard not always available.

29.22(a)-22, Appendix, *infra*. The underlying principle of these cases is succinctly stated in *Emery v. Commissioner*, *supra* p. 730, as follows:

We cannot see any valid reason for distinguishing between a settlor who reserves broad powers over a trust and a beneficiary who receives and retains such powers. The fact that the petitioner did not exercise her powers in her own favor during the taxable years does not make the income any less taxable to her. *Stockstrom v. Commissioner*, 8 Cir., 1945, 151 F. 2d 353, 356. In enacting §22(a) of the Internal Revenue Code, Congress intended "to use its constitutional powers of income taxation to their 'full measure'." *Helvering v. Stuart*, 1942, 317 U. S. 154, 168, 169, * * * It is not necessary that a taxpayer collect the income which is attributable to him for the purposes of income taxation. *Helvering v. Horst*, 1940, 311 U. S. 112 * * *; *Helvering v. Eubank*, 1940, 311 U. S. 112 * * *; *Helvering v. Clifford*, 1940, 309 U. S. 331 * * *. Where his control of a trust is so complete that it must be said that the taxpayer is the owner of the trust's income, then it is taxable to him. *Helvering v. Stuart*, *supra*.⁴

Flato v. Commissioner, 195 F. 2d 580 (C. A. 5th), presented a factual situation strikingly similar to the one at bar. There a share of two family partnerships was transferred in trust for the benefit of three sons, Franklin, Frederick and Robert. In all six trusts were created, two for each son. Franklin was made trustee of the two trusts for Frederick; Frederick was trustee for the two

⁴Indeed, following this rationale, grantors of reciprocal trusts have been held taxable on the income thereof. *Lehman v. Commissioner*, 109 F. 2d 99 (C. A. 2d), certiorari denied, 310 U. S. 637.

trusts for Franklin; and Franklin and Frederick were co-trustees of the two trusts for Robert. The trusts were all similar and gave the Trustees power to retain and reinvest the income or they could make distribution of both principal and income at their discretion. The trusts were irrevocable and for a ten year term. The Commissioner contended that the creation of the trusts was a mere sham and artifice and was solely an attempt to divide the partnership income six ways instead of three and that under the actualities of the case the trust income was taxable to the three brothers as partners under Section 22(a) of the Internal Revenue Code of 1939. Both the Tax Court and the Court of Appeals agreed with the Commissioner's view. The Court of Appeals pointed out that the Tax Court was justified in considering the results rather than the mere language of the instruments and concluded that the Tax Court's finding that the beneficiaries could have what they wanted of trust income was supported by the evidence and justified disregarding the trusts and taxing the sons with partnership income.

Taxpayers seek to lessen the impact of the *Flato* case by arguing (Br. 28-30) that that decision rested on the fact that there were actual distributions made to the sons, whereas in this case there were no distributions to taxpayers. However, the opinion in that case does not seem to be so limited, for the entire income of the trusts, whether distributed or not, was taxed to the sons, and the Court of Appeals noted (p. 582):

It is well established, of course, that where income is subject to one's unfettered command and he is free to enjoy it at his own option, he may be taxed on such income whether he elects to enjoy it or not. *Corliss v. Bowers*, 281 U. S. 376. * * * This principle is not limited to the grantor of a trust, but

is equally applicable to the beneficiary of a trust. *Bunting v. Commissioner of Internal Revenue*, 6 Cir., 164 F. 2d 443; *Grant v. Commissioner of Internal Revenue*, 5 Cir., 174 F. 2d 891.

Taxpayers also argue (Br. 24 *et seq.*) that one cannot be held to be the owner of trust corpus or income unless the trust instrument gives him express power over the corpus or income. It is submitted that this argument is merely that the form of the transaction shall control and unless the invalidity of the trust clearly appears on the face of the instrument it must be upheld. Such a rule is simply not recognized. In *Doll v. Commissioner*, 149 F. 2d 239, 244 (C. A. 8th), certiorari denied, 326 U. S. 725, in a family partnership case the court discussed the *Clifford-Horst* line of cases as they apply to intra-family arrangements at length and concluded:

We have here a written instrument which is sufficient to create a partnership, both at common law and under Missouri decisions. * * * The judgment here is at most an adjudication of what was never in doubt. The existence of such a contract is not determinative of this tax issue. There remains the impact of the test of an analysis of "all the circumstances attendant on its creation and operation." *Helvering v. Clifford*, 309 U. S. 331, 335, * * *. This test must be applied in view of the statutory scheme of taxation prescribed in §22(a), *Clifford* case, 309 U. S. at page 334, * * * and under the special scrutiny arising from the situation that only a husband and wife are parties to the contract. *Clifford* case, 309 U. S. at pages 335-337 * * *. The question posed for this analysis is whether this

contract caused "any substantial change in his [petitioner's] economic position." *Clifford* case, 309 U. S. at page 336 * * *. The answer is to be found in the pertinent facts. Determination of such fact situation is the exclusive province of the Tax Court and its decision must be upheld if based on substantial evidence.

See also *Paster v. Commissioner*, 245 F. 2d 381 (C. A. 8th), certiorari denied, 355 U. S. 876; and *Trousdale v. Commissioner*, 219 F. 2d 563 (C. A. 9th).

In summary, this case represents an admitted attempt to reduce taxes by having taxpayers hold part of their share of the family business in trust instead of outright. The reciprocal status of beneficiaries and trustees, the intimacies of the family setting, the complete disregarding of fiduciary duties, and the entire circumstances surrounding the transaction clearly justified the determination by both the Commissioner and the District Court that the trusts were illusory. As the Fifth Circuit aptly stated in the *Flato* case, *supra*, p. 582:

The incidence of taxation may not be avoided by mere "legal paraphernalia which inventive genius may construct," *Helvering v. Clifford*, 309 U. S. 331 * * * but the Court must look to the "whole nexus of relations between the settlor, the trustee and the beneficiary", *Helvering v. Elias*, 2 Cir., 122 F. 2d 171, 172, and if it concludes that in spite of the form resorted to in effecting a transaction, the results thereof give the beneficiary command over the distribution of the income of a trust, such income is taxable to the beneficiary.

Conclusion.

For the above reasons, the judgments of the District Court are correct and should be affirmed.

Respectfully submitted,

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February, 1958



APPENDIX.

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1 and 3, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

* * * *

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * *

(26 U.S.C. 1952 ed., Sec. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for

the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(26 U.S.C. 1952, ed., Sec. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-22 [as added by T.D. 5488, 1946-1 Cum. Bull. 19]. *Trust income taxable to person other than grantor.*—

Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, the income therefrom shall be included in computing the net income of such person. Even though such a power has been partially released or otherwise modified as that the person holding it can no longer vest the corpus or the income of the trust in himself, the income shall continue to

be taxable to such person if, after such release or modification, he has retained such control of the trust as would, within the principles of section 29.22(a)-21, subject a grantor of such a trust to tax on the income thereof. This section shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor is otherwise taxable under section 29.22(a)-21. See also section 29.166-2.

Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.

No. 15757

United States
Court of Appeals
for the Ninth Circuit

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

FILED

DEC 20 1957

PAUL P. TRENKLE, CLERK

Appeal from the United States District Court for the
Southern District of California,
Central Division.

No. 15757

**United States
Court of Appeals**
for the Ninth Circuit

LAURENCE V. KANTER,

Appellant,

vs.

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Transcript of Record

**Appeal from the United States District Court for the
Southern District of California,
Central Division.**

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[Clerk's Note: When deemed likely to be of an important nature errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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Washington 25, D. C.

In the United States District Court, Southern District of California, Central Division

No. 15350—W. M.

LAURENCE V. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT FOR THE RECOVERY OF INDIVIDUAL INCOME TAXES AND INTEREST THEREON ERRONEOUSLY AND ILLEGALLY COLLECTED

Comes now the plaintiff and complains of the defendant and for cause of action alleges:

I.

That at all times herein mentioned, plaintiff was, and now is, a resident of the County of Los Angeles, State of California, United States of America, within the Sixth Internal Revenue Collection District of the State of California.

II.

That at all times from and after the first day of July, 1943, and to and including October 31, 1949, Harry C. Westover was the duly appointed, qualified and acting Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California. That on or about October 31, 1949, the said

Harry C. Westover resigned as the Collector of Internal Revenue for said District. That the said Harry C. Westover is the person to whom [2*] the sums herein sought to be recovered were paid as hereinafter set forth.

III.

That this is an action for the recovery of Federal income taxes and interest for the calendar years 1945, 1946 and 1947, erroneously and illegally collected from plaintiff in the respective amounts of Seven Hundred Ninety-Four Dollars and Five cents (\$794.05) plus interest respecting the year 1945, Three Thousand Three Hundred Two Dollars and Seventy-Three cents (\$3,302.73) plus interest respecting the year 1946 and Four Thousand Five Hundred Fifty-Three Dollars and Fifty-Five cents (\$4,553.55) plus interest respecting the year 1947. That this Court has jurisdiction under the provisions of the Judicial Code of the United States, 28 U.S.C.A., Section 1346, Subsection (a)(1).

IV.

That during the calendar years 1945, 1946 and 1947, and thereafter plaintiff was the beneficiary of a certain trust created on or about March 3, 1944, by Minnie F. Kanter, his mother. That said trust created by Minnie F. Kanter was for a term of fifteen (15) years and ten (10) months and provided that during the term of said trust the income would be accumulated for the period March 3, 1944, to January 2, 1950, at which later date said accumu-

***Page numbering appearing at foot of page of original Certified Transcript of Record.**

lated income would be distributable to the plaintiff. That thereafter the income from the trust for the period January 3, 1950, to January 2, 1955, would be accumulated at which later date said accumulated income would become distributable to the plaintiff. That the income from the trust for the period January 3, 1955, to January 2, 1960, would be accumulated at which later date said accumulated income would become distributable to the plaintiff. That on the termination of the trust, all corpus and accumulated income would be distributed to plaintiff. That the trust instrument provided that the trust was irrevocable and the trustor, Minnie F. Kanter, [3] did not reserve any right to change, amend or alter the trust instrument or withdraw any of the property from the trust and said trustor retained no control over the trust corpus whatsoever. That upon the death of the plaintiff, prior to the termination of the trust, as beneficiary of the income and remainder, the principal and accumulated income would be distributed to the heirs of law of the plaintiff; provided, however, that in no event would any principal or income of the trust ever be distributed or revert to the trustor. That the trustor, Minnie F. Kanter, gave one hundred fifty (150) shares of the common stock of Shop 'N Save, a California corporation, to said trust as its corpus. That thereafter, on or about April 1, 1944, the corporation was dissolved and a limited partnership was organized pursuant to the limited partnership law of the State of California. That on the dissolution of the corporation the one hundred fifty (150) shares of capital stock of Shop

'N Save held by the trust as corpus were cancelled and delivered up in exchange for a 6.81 per cent undivided interest as a limited partner in the profits and assets of the limited partnership. That a certificate of limited partnership was duly executed and filed in the office of the county recorder of the County of Los Angeles on April 1, 1944. That during the years 1945, 1946 and 1947, the aforementioned trust was a limited partner in said limited partnership doing business under the name of "Kanter & Wolins." That during the years 1945, 1946 and 1947, the 6.81 percentage of the partnership income was pursuant to the terms of the trust agreement accumulated and added to the corpus of the trust and was not distributed to plaintiff.

V.

That on or about March 15, 1946, the trustees of the trust prepared and filed on behalf of the trust a fiduciary income tax return respecting the trust's 6.81 percentage of the distributable share of the limited partnership income for the calendar [4] year 1945 and because said income was not distributed to beneficiaries the return reported and showed a tax payable on account of such income. That the income tax due respecting said income was paid by the trustees to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. That on or about March 15, 1947, the trustees of the trust prepared and filed on behalf of the trust a fiduciary income tax return respecting the trust's 6.81 percentage of the distributable share of the limited partnership

income for the calendar year 1946 and because said income was not distributed to beneficiaries the return reported and showed a tax payable on account of such income. That the income tax due respecting said income was paid by the trustees to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. That on or about March 15, 1948, the trustees of the trust prepared and filed on behalf of the trust a fiduciary income tax return respecting the trust's 6.81 percentage of the distributable share of the limited partnership income for the calendar year 1947 and because said income was not distributed to beneficiaries the return reported and showed a tax payable on account of such income. That the income tax due respecting said income was paid to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. That pursuant to Section 162 of the Internal Revenue Code, in each of the years 1945, 1946 and 1947, the entire income of the trust was to be accumulated and added to corpus and not distributed to the beneficiary and accordingly the income tax respecting said income was properly reported and paid by the trustees on behalf of the trust.

VI.

That on or about June 18, 1948, the Commissioner of Internal Revenue mailed to plaintiff a thirty-day letter wherein [5] said Commissioner proposed to assess against the plaintiff a deficiency in income

taxes for the calendar year 1945 on the theory that the income of the trust was properly reportable in the taxable income of the plaintiff as the beneficiary of the trust. That on or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against plaintiff in the amount of Eight Hundred Three Dollars and Seventy-Two cents (\$803.72) plus interest, and that on or about February 25, 1949, plaintiff paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

That on or about March 21, 1949, a similar thirty-day letter was mailed to the plaintiff wherein the Commissioner of Internal Revenue proposed a similar deficiency against plaintiff for the taxable years 1946 and 1947. That on or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1946 against plaintiff in the amount of Three Thousand Four Hundred Eighty-Eight Dollars and Sixty-Four cents (\$3,488.64) plus interest, and that on or about June 9, 1949, plaintiff paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California. That on or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1947 against plaintiff in the amount of Five Thousand Four Hundred Ninety-Two Dollars and Sixty-Two

cents (\$5,492.62) plus interest, and that on or about June 9, 1949, plaintiff paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

VII.

That on or about August 12, 1950, the plaintiff caused to be filed with Harry C. Westover, Collector of Internal Revenue, [6] for the Sixth Internal Revenue Collection District of California, his written claim for refund of income taxes and interest erroneously assessed and collected from plaintiff as aforesaid for the calendar years 1945, 1946 and 1947. That said claims sought the recovery of the sum of Seven Hundred Ninety-Four Dollars and Five cents (\$794.05) plus interest respecting the calendar year 1945, Three Thousand Three Hundred Two Dollars and Seventy-Three cents (\$3,302.73) plus interest respecting the year 1946 and Four Thousand Five Hundred Fifty-Three Dollars and Fifty-Five cents (\$4,553.55) plus tax respecting the calendar year 1947, that being those portions of the deficiencies asserted aforesaid which related to the inclusion in plaintiff's gross income of the income of the trust. That said claims for refund were based upon the same grounds and facts relied upon herein.

VIII.

That on April 5, 1951, the Commissioner of Internal Revenue disallowed the claims for refund respecting the calendar years 1946 and 1947 by sending a notice of disallowance to that effect by reg-

istered mail to plaintiff. A copy of said notice is attached hereto marked Exhibit "A," and is hereby made a part hereof as though the same were written at length herein. That although more than six (6) months has elapsed since the filing of said claim, plaintiff has not received notice of disallowance of the claim for refund respecting the year 1945.

IX.

That no part of said sum sought to be refunded by said claims, as and for income taxes and interest as aforesaid, has been refunded to plaintiff by defendant or any other person. That no action has been had in Congress upon said claims for refund, or in any department of the Government. That plaintiff is the sole owner of said claims for refund herein sued upon and has not at any time assigned or transferred said claims; that plaintiff is [7] entitled to the amount herein claimed from the defendant and there is no just credit or offset against said claims which is known to the plaintiff.

X.

That the income of the trust for the calendar years 1945, 1946 and 1947, was pursuant to the terms of the trust instrument accumulated and added to corpus. That pursuant to the terms of Section 162 of the Internal Revenue Code, Federal income tax respecting said income of the trust was properly payable by the trustees as the fiduciary of the trust and was not properly taxable to or reportable by the beneficiary, the plaintiff herein. That by reason of

the inclusion of such trust income in the taxable income of the plaintiff, income taxes for the year 1945 of Seven Hundred Ninety-Four Dollars and Five cents (\$794.05) plus interest and for the year 1946 of Three Thousand Three Hundred Two Dollars and Seventy-Three cents (\$3,302.73) plus interest and for the year 1947 of Four Thousand Five Hundred Fifty-Three Dollars and Fifty-Five cents (\$4,553.55) plus interest were erroneously collected from plaintiff. That the whole amount thereof, namely, Eight Thousand Six Hundred Fifty Dollars and Thirty-Three cents (\$8,650.33) plus interest together with interest thereon as provided by law is now due and owing to said plaintiff.

Wherefore, plaintiff prays for judgment against the defendant in the sum of Eight Thousand Six Hundred Fifty Dollars and Thirty-Three cents (\$8,650.33) together with interest thereon as provided by law and for such other and further relief as to the Court may seem just and proper in the premises.

ADAMS, DUQUE &
HAZELTINE,

By /s/ BRYANT R. BURTON,
Attorneys for Plaintiff. [8]

EXHIBIT A

U. S. Treasury Department
Washington 25

Apr. 5, 1957

Office of
Commissioner of Internal Revenue

Address reply to
Commissioner of Internal Revenue
and refer to

IT:C1:CC:Rej

Lawrence V. Kanter
10100 Sunset Blvd.
Los Angeles, California

In re: Claims for refund of \$3,302.73;
\$4,553.55 for the years 1946 and 1947.

Dear Mr. Kanter:

In accordance with the provisions of section 3772 (a)(2) of the Internal Revenue Code, this notice of disallowance in full of your claim or claims is hereby given by registered mail.

By direction of the Commissioner:

Very truly yours,

/s/ E. J. McLARNEY,
Deputy Commissioner.

[Endorsed]: Filed April 3, 1953. [9]

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, United States of America, in the above-entitled action and in answer to plaintiff's complaint, admits, denies and alleges:

I.

The defendant admits the allegations of paragraph I of the complaint.

II.

The defendant admits the allegations of paragraph II of the complaint.

III.

The defendant admits the allegations of paragraph III of the complaint, except that it denies that any part of the tax complained of was erroneously or illegally collected.

IV.

The defendant says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph IV of the complaint. [10]

V.

(a) The defendant says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph V of the complaint which relate to the calendar year 1945.

(b) The defendant admits the allegations of paragraph V of the complaint regarding the filing of tax returns and payment of tax for each of the calendar years 1946 and 1947. It says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of said paragraph regarding the percentage share of alleged limited partnership income of the alleged trust, and regarding the alleged non-distribution of income of the alleged trust to its beneficiaries, for each of the calendar years 1946 and 1947.

(c) The defendant further says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of the last sentence of paragraph V of the complaint.

VI.

(a) The defendant says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of the first sentence of paragraph VI of the complaint.

(b) The defendant admits assessment against and payment by plaintiff of a deficiency in income taxes for the year 1945 as alleged in paragraph VI of the complaint, except that it says such payment was made on or about March 15, 1949.

(c) The defendant admits the allegations of the first sentence of the second paragraph of paragraph VI of the complaint, except that it says it is without knowledge or information sufficient to make a responsive pleading to the word "similar" therein.

(d) The defendant admits assessment against plaintiff of deficiencies in income taxes for the years 1946 and 1947 as alleged in paragraph VI of the complaint, but it says that the [11] deficiencies so assessed were satisfied as follows:

1946 Additional:

Paid 6/28/49\$ 267.08

Offset of overassessments:

Laurence V. Kanter Trust #2, 1946.. 1,501.86

Laurence V. Kanter Trust #6, 1946.. 36.43

Laurence V. Kanter Trust #2, 1947.. 1,862.70

Laurence V. Kanter Trust #6, 1947.. 250.10

\$3,918.17

1947 Additional:

Paid 6/9/49\$ 722.20

Monthly Payments of \$568.57 each

September, 1949-May, 1950..... 5,117.13

Paid 5/18/50 189.07

\$6,028.40

VII.

The defendant admits the allegations of paragraph VII of the complaint, except that it denies that any part of the taxes complained of was erroneously assessed or collected.

VIII.

The defendant admits the allegations of paragraph VIII of the complaint.

IX.

The defendant admits the allegations contained in the first two sentences of paragraph IX of the complaint. It denies the remaining allegations of that paragraph.

X.

The defendant says that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of the first and second sentences of paragraph X of the [12] complaint. It denies the remaining allegations of that paragraph.

Wherefore, having fully answered, defendant demands judgment against the plaintiff, dismissing his action with prejudice, and awarding to it all lawful costs and disbursements.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant United States At-
torney, Chief, Tax Division.

/s/ EDWARD R. McHALE,
Attorneys for Defendant.

Affidavit of service by mail attached.

[Endorsed]: Filed March 16, 1955. [13]

United States District Court for the Southern
District of California, Central Division

No. 15350-WM Civil

LAURENCE V. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15399-WM Civil

RUTH WOLINS,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15534-WM Civil

JEROME B. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

STIPULATION OF FACT

It Is Hereby Stipulated and Agreed by and between the parties hereto through their respective counsel, without prejudice to the rights of any party herein to introduce additional evidence not incon-

sistent herewith, and without prejudice to their right to object to the materiality or relevancy of any of the facts agreed to, as follows: [15]

I.

On the 3rd day of March, 1944, Minnie F. Kanter as trustor executed a certain Declaration of Trust (hereinafter referred to as the Laurence V. Kanter Trust), a copy of which is attached hereto as Exhibit A, with Albert L. Wolins and Ruth Wolins as trustees and Laurence V. Kanter as beneficiary. Simultaneously Minnie F. Kanter executed a substantially identical Declaration of Trust (hereinafter referred to as the Jerome B. Kanter Trust), a copy of which is attached hereto as Exhibit B, with Ruth Wolins and Laurence V. Kanter as trustees and Jerome B. Kanter as beneficiary. Also simultaneously Minnie F. Kanter executed a substantially identical Declaration of Trust (hereinafter referred to as the Ruth Wolins Trust), a copy of which is attached hereto as Exhibit C, with Laurence V. Kanter and Albert L. Wolins as trustees and Ruth Wolins as beneficiary. Laurence V. Kanter and Jerome B. Kanter are sons of the trustor, and Ruth Wolins is the daughter of the trustor. Albert L. Wolins is the husband of Ruth Wolins. There was assigned, delivered and endorsed 150 shares of common stock of Shop 'N Save, a California corporation, as the original corpus of each of said trusts.

II.

On or about April 1, 1944, Shop 'N Save, a California corporation, was partially liquidated and a

limited partnership, under the name of Kanter & Wolins (hereinafter referred to as "Kanter & Wolins") was organized pursuant to the Limited Partnership Law of the State of California. On the partial liquidation of the corporation, the shares of capital stock held by the respective trusts as corpus were cancelled and delivered in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. A Certificate of Limited Partnership, a copy of which is attached hereto as Exhibit D, was duly executed and filed in the office of the County Recorder of Los Angeles County on April 1, 1944, and in said certificate of limited partnership the Laurence V. Kanter Trust, the Jerome B. Kanter Trust, and the Ruth Wolins Trust were each listed as limited partners to the extent of \$15,900.00 each, which represented a [16] 6.81% undivided interest as a limited partner in Kanter & Wolins.

III.

During the years 1945, 1946 and 1947, the limited partnership filed partnership income tax returns on which it listed each of the aforementioned trusts as being limited partners, and as such chargeable with their distributable shares of the partnership profits. During such years the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Wolins Trust did not distribute any part of the trust income to the beneficiaries.

IV.

On or about March 15, 1945, Minnie Kanter, trustor, filed a gift tax return in which she declared

as gifts to Laurence V. Kanter, Jerome B. Kanter and Ruth Wolins the sum of \$15,900.00 as representing the fair market value of the 150 shares of common capital stock of Shop 'N Save transferred to each of the trusts. In such gift tax return she claimed the benefit of the \$3,000.00 annual exclusion for gifts made to any one person. Thereafter the Commissioner of Internal Revenue asserted a gift tax deficiency with respect to such transfers on the grounds that the transfers in trust represented gifts of a future interest with regard to which the \$3,000.00 annual exclusion for gifts to individuals is not applicable, and a gift tax deficiency of \$742.50 was paid by Minnie Kanter.

V.

On or before the 15th day of March, 1946, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Wolins Trust prepared and filed on behalf of such trusts fiduciary income tax returns for the calendar year 1945, and reported in each fiduciary return the trust's 6.81 percentage of the distributable share of the Kanter & Wolin's partnership income for the fiscal year April 1, 1944, to March 31, 1945. Because such trust income was not distributed to the beneficiary, the return reported and showed a tax payable by the trust on account of such income. The income tax respecting such income was duly paid by the trustees of each of the trusts, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth [17] Internal Revenue District of California.

VI.

On or before the 15th day of March, 1947, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Wolins Trust prepared and filed on behalf of such trusts fiduciary income tax returns for the calendar year 1946, and reported in each fiduciary return the trust's 6.81 percentage of the distributable share of the Kanter & Wolins' partnership income for the fiscal year April 1, 1945, to March 31, 1946. Because such trust income was not distributed to the beneficiary, the return reported and showed a tax payable by the trust on account of such income. The income tax due respecting such income was duly paid by the trustees of each of the trusts, to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

VII.

On or before the 15th day of March, 1948, the trustees of the Laurence V. Kanter Trust, the Jerome B. Kanter Trust and the Ruth Wolins Trust prepared and filed on behalf of such trusts fiduciary income tax returns for the calendar year 1947, and reported in each fiduciary return the trust's 6.81 percentage of the distributable share of the Kanter & Wolins' partnership income for the fiscal year April 1, 1946, to March 31, 1947. Because such trust income was not distributed to the beneficiary, the return reported and showed a tax payable by the trust on account of such income. The income tax due respecting such income was duly paid by the trustees of each of the trusts, to the

Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

VIII.

On or about June 18, 1948, the Commissioner of Internal Revenue mailed to Laurence V. Kanter a thirty-day letter wherein said Commissioner proposed to assess against said Laurence V. Kanter a deficiency in income taxes for the calendar year 1945 on the theory that the income of the Laurence V. Kanter Trust was properly reportable in the taxable income of Laurence V. Kanter as the beneficiary of the trust. On or about November 1, 1948, the [18] Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Laurence V. Kanter in the amount of \$803.72 plus interest, and on or about March 15, 1949, Laurence V. Kanter paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

On or about March 21, 1949, a thirty-day letter was mailed to Laurence V. Kanter wherein the Commissioner of Internal Revenue proposed a deficiency against said Laurence V. Kanter for the taxable years 1946 and 1947 on the same grounds as with regard to the year 1945. On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1946 against Laurence V. Kanter in the amount of \$3488.64 plus interest, and on or about June 28, 1949, Laurence V. Kanter paid said

amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California, as follows:

1946 Additional:

Paid June 28, 1949\$ 267.08

Offset of overassessments:

Laurence V. Kanter

Trust No. 2, 1946 1,501.86

Laurence V. Kanter

Trust No. 6, 1946 36.43

Laurence V. Kanter

Trust No. 2, 1947 1,862.70

Laurence V. Kanter

Trust No. 6, 1947 250.10

\$3,918.17

On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1947 against said Laurence V. Kanter in the amount of \$5492.62 plus interest, and Laurence V. Kanter paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California, as follows:

1947 Additional:

Paid June 9, 1949 [19].....\$ 722.20

Monthly Payments of \$568.57 each

September, 1949-May, 1950 5,117.13

Paid May 18, 1950 189.07

\$6,028.40

IX.

On or about June 18, 1948, the Commissioner of Internal Revenue mailed to Jerome B. Kanter a thirty-day letter wherein said Commissioner proposed to assess against said Jerome B. Kanter a deficiency in income taxes for the calendar year 1945 on the theory that the income of the Jerome B. Kanter Trust was properly reportable in the taxable income of Jerome B. Kanter as the beneficiary of the trust. On or about January 7, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Jerome B. Kanter in the amount of \$375.32 plus interest, and on or about March 15, 1949, Jerome B. Kanter paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

On or about March 21, 1949, a thirty-day letter was mailed to Jerome B. Kanter wherein the Commissioner of Internal Revenue proposed a deficiency against said Jerome B. Kanter for the taxable years 1946 and 1947 on the same grounds as with regard to the year 1945. On or about May 20, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1946 against Jerome B. Kanter in the amount of \$2,461.23 plus interest, and Jerome B. Kanter paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the

Sixth Internal Revenue District of California, as follows:

1946 Additional:

Offset of Overassessments:

Jerome B. Kanter Trust No. 1, 1946..\$1,501.86

Jerome B. Kanter Trust No. 5, 1946.. 36.43

Jerome B. Kanter Trust No. 1, 1947.. 1,225.97

\$2,764.26

On or about May 20, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1947 against said Jerome B. Kanter in the amount of \$3,624.74 plus interest, and Jerome B. Kanter paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California, as follows:

1947 Additional:

Paid June 9, 1949\$2,966.71

Offset of Overassessments:

Jerome B. Kanter Trust No. 1, 1947.. 636.73

Jerome B. Kanter Trust No. 5, 1947.. 250.10

\$3,853.54

X.

On or about June 18, 1948, the Commissioner of Internal Revenue mailed to Ruth Wolins a thirty-day letter wherein said Commissioner proposed to assess against said Ruth Wolins a deficiency in income taxes for the calendar year 1945 on the

theory that the income of the Ruth Wolins Trust was properly reportable in the taxable income of Ruth Wolins as the beneficiary of the trust. On or about November 1, 1948, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1945 against Ruth Wolins in the amount of \$1,129.30 plus interest, and on or about March 15, 1949, Ruth Wolins paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

On or about March 21, 1949, a thirty-day letter was mailed to Ruth Wolins wherein the Commissioner of Internal Revenue proposed a deficiency against said Ruth Wolins for the taxable years 1946 and 1947 on the same grounds as with regard to the year 1945. On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1946 against Ruth Wolins in the amount of \$4,482.70 plus interest, and on or about June 9, 1949, Ruth Wolins paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, [21] for the Sixth Internal Revenue District of California, as follows:

1946 Additional:

Paid June 9, 1949.....\$ 444.11

Offset of Overassessments:

Albert L. Wolins, 1946	318.95
Albert L. Wolins, 1947	620.46
Ruth Wolins Trust No. 3, 1946	1,501.86

Ruth Wolins Trust No. 7, 1946	36.43
Ruth Wolins Trust No. 3, 1947	1,862.70
Ruth Wolins Trust No. 7, 1947	250.10
	<hr/>
	\$5,034.61

On or about March 30, 1949, the Commissioner of Internal Revenue assessed a deficiency in income taxes respecting the year 1947 against said Ruth Wolins in the amount of \$8,278.77 plus interest, and on or about June 9, 1949, Ruth Wolins paid said amount plus interest to the Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California, as follows:

1947 Additional:

Paid June 9, 1949	\$1,088.60
Monthly Payments of \$856.97 each	
September, 1949-May, 1950	7,712.73
	<hr/>
	\$8,801.33

Dated: This 1st day of February, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief,
Tax Division;

By /s/ EDWARD R. McHALE,
Attorneys for Defendant.

ADAMS, DUQUE &
HAZELTINE,

By /s/ BRYANT R. BUSTON,
Attorneys for Plaintiff.

[Endorsed]: Filed February 1, 1957. [22]

[Title of District Court and Cause.]

ORDER FOR FINDINGS OF FACT,
CONCLUSIONS OF LAW, AND JUDGMENT

The three above-numbered cases having been tried jointly pursuant to Rule 42(a) of the Federal Rules of Civil Procedure and submitted for decision, Findings of Fact, [23] Conclusions of Law, and Judgment are now ordered in favor of defendant and against plaintiff in each case; and will be lodged with the Clerk by the attorneys for defendant, pursuant to local rule 7, within ten days.

It Is Further Ordered that the Clerk this day serve copies of this order by United States mail upon the attorneys for the parties appearing in these causes.

June 28, 1957.

/s/ WM. C. MATHES,
United States District Judge.

[Endorsed]: Filed July 2, 1957. [24]

United States District Court for the Southern
District of California, Central Division

No. 15350-WM Civil

LAURENCE V. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF
LAW, AND JUDGMENT

The above case, together with its companion cases of Ruth Wolins v. United States of America, No. 15399-WM Civil, and Jerome B. Kanter v. United States of America, No. 15334-WM Civil, came on for trial before the Honorable Wm. C. Mathes, United States District Judge, presiding, sitting without a jury, on March 4, 1957, the plaintiff represented by his attorneys, Adams, Duque & Hazeltine, Burton and Zerwekh, by Bryant R. Burton and Joseph A. Zerwekh, Esquires, the defendant represented by Laughlin E. Waters, United States Attorney, Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, Sidney J. Machtinger, Attorney, Internal Revenue Service, by Edward R. McHale, Esq., and joint stipulations of fact and exhibits having duly been introduced into evidence, and the case having been submitted, and the Court having examined the briefs and arguments

of the parties, now, being fully advised in the premises, finds as follows: [25]

Findings of Fact

I.

At all times herein mentioned, plaintiff was, and now is, a resident of the County of Los Angeles, State of California, United States of America, within the Sixth Internal Revenue Collection District of the State of California.

II.

At all times from and after the first day of July, 1943, and to and including October 31, 1949, Harry C. Westover was the duly appointed, qualified and acting Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California. On or about October 31, 1949, the said Harry C. Westover resigned as the Collector of Internal Revenue for said District. The said Harry C. Westover is the person to whom the sums sought to be recovered were paid.

III.

This is an action for the recovery of federal income taxes and interest for the calendar years 1945, 1946, and 1947, collected from plaintiff in the respective amounts of \$794.05 plus interest for the year 1945; \$3,302.73 plus interest for the year 1946, and \$4,553.55 plus interest for the year 1947. The Court has jurisdiction under the provisions of Title 28, U.S.C. § 1346(a)(1).

IV.

Prior to and during the early part of 1944, the Kanter family, consisting of Harry L. Kanter and Minnie Kanter, his wife, and their three adult children, Laurence V. Kanter, Jerome B. Kanter, and Ruth Kanter Wolins, operated a chain retail food and liquor business under the name of Shop 'N Save, a California corporation. The three children each owned 6.81 per cent of the stock; the father owned 13.31 per cent, and the mother owned the remaining 66.26 per cent.

V.

During the early part of 1944, the stockholders agreed to [26] terminate the corporation and form a limited partnership to conduct the identical business then being conducted in corporate form. At the same time, Minnie Kanter decided to make a gift of a portion of her interest in the business to each of her children in order to reduce the taxes that her children would have to pay on the income of the proposed gift by her. Minnie Kanter established a trust of 6.81 per cent interests for each of her children. No business purpose existed for the gifts and trusts created thereby, and the trust medium, as opposed to outright gifts, was employed in order to reduce the income taxes that the children would have to pay on the income from the property gifted to them. In all respects as to the mother the gifts were valid, Minnie Kanter having effectively parted with all control over the property transferred in trust and having paid gift taxes on the transfers.

VI.

For convenience the trusts are herein referred to in terms of the chief beneficiary. The trustees of the Laurence V. Kanter trust were Laurence's sister, Ruth Kanter Wolins, and her husband, Albert Wolins. The trustees for the Jerome B. Kanter trust were his sister, Ruth Kanter Wolins, and his brother, Laurence. The trustees for the Ruth Kanter Wolins trust were her husband, Albert Wolins, and her brother, Laurence. Pursuant to the terms of the Ruth Kanter Wolins trust, Albert Wolins, Laurence V. Kanter and Jerome B. Kanter were "secondary beneficiaries" thereof, Albert Wolins possessing an interest in the trust property contingent on Ruth's death before January 2, 1960, and Jerome B. Kanter and Laurence V. Kanter having interest contingent on Ruth's death before January 2, 1960, without lawful issue or a lawful spouse surviving her. Likewise, in addition to being trustees of the Jerome B. Kanter trust, Ruth Kanter Wolins and Laurence V. Kanter were "secondary beneficiaries" thereof, each having interests contingent on Jerome B. Kanter's death before January 2, 1960, without lawful issue or lawful spouse surviving him. [27] Jerome B. Kanter and Ruth Kanter Wolins were likewise similar contingent and "secondary beneficiaries" of the Laurence V. Kanter trust.

VII.

The dissolution of the corporation, Shop 'N Save, and the organization of a limited partnership to succeed the corporation was within the contempla-

tion of the shareholders prior to the execution of these trusts by Minnie Kanter.

VIII.

On or about April 1, 1944, Shop 'N Save was partially liquidated and a limited partnership under the name of Kanter & Wolins was organized. On the partial liquidation of the corporation, the shares of capital stock held by the shareholders were cancelled in exchange for interests as limited partners in the assets and profits of Kanter & Wolins. The shares of capital stock which were to have been placed in the corpus of each trust executed by Minnie Kanter were thus cancelled and the value of the corpus of each trust was credited to the capital account of each trust on the books of the Kanter & Wolins partnership. No separate books were kept for the trusts. All transactions affecting the trusts were reflected only in the capital accounts of the trusts as limited partners on the books of the partnership.

IX.

A Certificate of Limited Partnership was executed and filed in the office of the County Recorder of Los Angeles County on April 1, 1944. This certificate reflected the agreement of Limited Partnership entered into on March 31, 1944. The general partners, the limited partners, their capital investments and their percentage ownership of capital and profits, as provided for in the partnership agreement, are as follows: [28]

General Partners	Capital Investment	Per Cent of Capital and Profits
Harry L. Kanter	\$ 31,058.00	13.31%
Laurence V. Kanter	15,910.00	6.81%
Albert L. Wolins	10,600.00	4.54%
Limited Partners		
Minnie F. Kanter	105,894.00	45.37%
Jerome B. Kanter	15,900.00	6.81%
Ruth Wolins	5,300.00	2.27%
Trust No. 1 (for Jerome B. Kanter)	15,900.00	6.81%
Trust No. 2 (for Laurence V. Kanter)	15,900.00	6.81%
Trust No. 3 (for Ruth Wolins)	15,900.00	6.81%
Trust No. 4 (for Sue Ellen Wolins)	1,060.00	.46%

Thus, each of the children of Harry and Minnie Kanter had, in his own right, as a general or limited partner, a 6.81% interest in the capital and profits of the Kanter & Wolins partnership (the combined interest of Ruth Kanter Wolins and her husband, Albert L. Wolins, totaling 6.81%). In addition, each of the children of Harry and Minnie Kanter was the beneficiary of a trust which had a 6.81% interest in the capital and profits of Kanter & Wolins. And each of the two trustees of each trust was also a general or limited partner in Kanter & Wolins in his own right in addition to being a trustee of a limited partner.

X.

The capital investment of each of the partners consisted of his stock in Shop 'N Save. The terms for which the limited partnership was to exist were from April 1, 1944, until March 31, 1954, and there-

after in five-year periods during the mutual agreement of the general partners. Although there was no restriction on the right [29] of a general partner to assign all or a portion of his interest in the partnership, Paragraph Eight of the partnership agreement expressly prohibited the assignment of the interest of a limited partner.

XI.

On or before March 15, 1946; March 15, 1947, and March 15, 1948, the trustees of the Laurence V. Kanter trust, the Jerome B. Kanter trust and the Ruth Wolins trust prepared and filed on behalf of such trusts fiduciary income tax returns for the calendar years 1945, 1946, and 1947, and reported in each fiduciary return each trust's 6.81 percentage of the distributable share of the Kanter & Wolins partnership income for these calendar years. Because such trust income was not distributed to the beneficiary, the return reported and showed a tax payable by the trust on account of such income. The income tax respecting such income was duly paid by the trustees of each of the trusts, to the then Collector of Internal Revenue, Los Angeles, California, for the Sixth Internal Revenue District of California.

XII.

During the years 1945, 1946, and 1947, the limited partnership filed partnership income tax returns on which it listed each of the aforementioned trusts as being limited partners, and as such chargeable with their distributable shares of the partnership profits.

During such years the trustees of the Laurence V. Kanter trust, the Jerome B. Kanter trust, and the Ruth Wolins trust, did not distribute any part of the trust income to the beneficiaries.

XIII.

After auditing the income tax returns of the respective trusts for the calendar years 1945, 1946, and 1947, the Commissioner of Internal Revenue determined that the income of the trusts of which each of these individuals was beneficiary was properly includible in their individual income and assessed deficiencies [30] against Laurence V. Kanter, Jerome B. Kanter and Ruth Kanter Wolins for each of the years, as follows:

	1945	1946	1947
Laurence V. Kanter	\$ 803.72	\$3,488.64	\$5,492.62
Jerome B. Kanter	375.32	2,461.23	3,624.74
Ruth Kanter Wolins	1,129.30	4,482.70	8,278.77

XIV.

The amounts set forth in the preceding paragraph, together with interest, were paid by the respective individuals and, on or about August 12, 1950, timely claims for refund, as follows, were filed seeking recovery of that portion of the deficiency plus interest which related to the inclusion in the beneficiaries' gross income of the income of the trust:

	1945	1946	1947	Total
Laurence V. Kanter	\$794.05	\$3,302.73	\$4,553.55	\$8,650.33
Jerome B. Kanter	375.32	1,956.41	2,751.18	5,082.91
Ruth Kanter Wolins	869.20	3,567.13	5,346.20	9,782.53

XV.

At the time of the execution of these trusts and during the years before this Court, the income tax on income from the property gifted by Minnie Kanter would have been taxed at a higher tax rate if distributed directly to Laurence Kanter, Jerome Kanter and Ruth Wolins than if taxed at the rates imposed against trusts.

XVI.

The trust agreements gave the trustees unlimited broad powers of investment and management of trust corpus. Paragraphs Third provided that terms of each trust were established at 15 years and 10 months with said term divided into three periods:

(1) "Period A" was to start March 3, 1944, and terminate on January 2, 1950;

(2) "Period B" was to start on January 3, 1950, and terminate on January 2, 1955; and [31]

(3) "Period C" was to start on January 3, 1955, and terminate on January 2, 1960.

All income from the trust during "Period A" was to be available for distribution in the trust estate and the accumulated income during that period "shall be distributed to the beneficiary hereof on the 2nd day of January, 1950." Similarly, with "Period B," "All net income from the Trust Estate during 'Period B' shall be accumulated and distributed to the beneficiary hereinafter named on the 2nd day of January, 1955." With respect to "Period C," all accumulated net income, together with all other income and principal of the Trust Estate, was

to be distributed on the 2nd day of January, 1960, the date on which the trust was to cease and terminate.

XVII.

Paragraphs Fifth gave the trustees discretion to distribute income to the beneficiary at any time as follows:

“In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.”

XVIII.

The original value of the corpus of each trust as of March 3, 1944, was \$15,900.00. Between April 1, 1944, and January 2, 1950, the limited partnership income of each of the trusts was credited by the Kanter & Wolins partnership to each trust as follows:

March 31, 1945.....	\$2,075.39
March 31, 1946.....	6,881.59
March 31, 1947.....	8,107.78
March 31, 1948.....	7,622.31
March 31, 1949.....	9,514.48

As of January 2, 1950, the capital account of each trust as reflected on the books of Kanter & Wolins after deducting expenses of administering each trust was as follows:

Jerome B. Kanter, Trust No. 1	\$45,100.57
Laurence V. Kanter, Trust No. 2	43,958.11
Ruth Wolins, Trust No. 3	43,729.66

Despite the express provisions of Paragraph Third of the trust directing that undistributed income accumulated between March 3, 1944, and January 2, 1950, "shall be distributed to the beneficiary hereof on the 2nd day of January, 1950," the income of the trusts was never distributed but was credited to the capital accounts of the trusts and retained in the Kanter & Wolins partnership.

XIX.

On January 9, 1950, the Kanter & Wolins partnership exchanged substantially all of its assets for all of the common stock in a corporation newly formed by the partnership called McDaniel's Markets. The total capital of McDaniel's Markets per its books was \$416,810.00, representing the value of the assets of the Kanter & Wolins partnership transferred to the corporation.

XX.

On May 31, 1950, the partnership books were posted to show the investment of \$416,810.78 of partnership net worth in the common stock of the corporation which reflected the following investment by the trusts in said common stock:

Jerome B. Kanter, Trust No. 1	\$42,456.11
Laurence V. Kanter, Trust No. 2	41,313.65
Ruth Wolins, Trust No. 3	41,085.20

This left the following balances in said limited partners' accounts invested in the remaining assets of the partnership: [33]

Jerome B. Kanter, Trust No. 1.....	\$3,364.56
Laurence V. Kanter, Trust No. 2.....	3,364.56
Ruth Wolins, Trust No. 3.....	3,364.56

Between January 10, 1950, and January 10, 1956, McDaniel's Markets incurred a total operating deficit of \$247,619.93, which arose as follows:

Net loss fiscal year 1951.....	(\$ 23,921.08)
Net loss fiscal year 1952.....	(194,707.19)
Net profit fiscal year 1953.....	36,990.24
Net profit fiscal year 1954.....	95,503.62
Net loss fiscal year 1955.....	(76,506.89)
Net loss fiscal year 1956.....	(84,978.23)

Deficit in surplus account as
of May 31, 1956.....(\$247,619.93)

XXI.

Between January 2, 1950, and January 2, 1955, the limited partnership income or loss for each of the trusts was credited by the Kanter & Wolins partnership to the trusts as follows:

March 31, 1950.....	(\$2,569.82)
March 31, 1951.....	1,210.25
March 31, 1952.....	21.78
March 31, 1953.....	(136.19)
March 31, 1954.....	207.58

XXII.

As of January 2, 1955, the capital account of each trust as reflected on the books of the Kanter & Wolins partnership after deducting expenses of administering each trust was as follows:

Jerome B. Kanter, Trust No. 1.....	\$47,198.73
Laurence V. Kanter, Trust No. 2.....	46,056.27
Ruth Wolins, Trust No. 3.....	45,827.82

XXIII.

No dividends on the common stock have ever been declared [34] by McDaniel's Markets and the Kanter & Wolins partnership continues to hold all the common stock in the corporation.

XXIV.

Preferred stock was issued by the corporation in order to obtain outside capital and at various dates the following amounts of preferred stock were outstanding:

May 31, 1951.....	\$125,000
May 31, 1952.....	180,200
May 31, 1953.....	181,275
May 31, 1954.....	181,275
May 31, 1955.....	181,275
May 31, 1956.....	240,225

Preferred stock dividends were paid as follows for the years ending May 31:

May 31, 1951.....	\$ 6,250.00
May 31, 1952.....	7,856.96
May 31, 1953.....	10,876.50

May 31, 1954.....	10,876.50
May 31, 1955.....	10,876.50

XXV.

The creation of the trusts by Minnie Kanter for her three children of portions of her interest in the family business did not provide the business with any additional capital; it was a tax minimization device in that it shifted ownership of a part of the capital already in the business from the mother to her children and was designed to prevent the inclusion of the income therefrom in that of the children. Family motives impelled the gifts in trusts.

XXVI.

The beneficiaries of the trusts had unlimited power and control over the corpus of the trust because of the reciprocal nature of the trusts—the lack of independent trustees, the close familial, business and trust relationship of the trustees with each other, and [35] the unlimited powers of invasion of the corpus.

XXVII.

From the inception of the partnership until the formation of the corporation in 1950, none of the assets was ever withdrawn from the limited partnership and no part of the earnings which were accumulated was ever invested in any other type of investment.

XXVIII.

The mandatory directions of the trusts to distribute the accumulation at the end of any of the

five-year periods were never complied with by the trustees.

XXIX.

The trustees permitted the corpus of the trusts to remain in the limited partnership which in 1950 acquired common stock in the corporation despite losses in four of the next six years amounting to a net deficit of \$247,619.93.

XXX.

The trustees of the trusts exercised no independent fiduciary judgment in permitting the bulk of the corpus of the trusts to remain in a business that was losing money, in permitting the subordination of the investment to new issues of preferred stock, and in permitting the bulk of the investment to remain in common stock which failed to pay dividends.

XXXI.

All conclusions of law which are or are deemed to be findings of fact are hereby incorporated and found as findings of fact.

Conclusions of Law

And from the foregoing facts the Court concludes as follows:

I.

The Court has jurisdiction of this controversy and of the parties hereto.

II.

The plaintiff has failed to sustain his burden of proving [36] that he has overpaid his income taxes for the years 1945, 1946, and 1947.

III.

The undistributed income of the Laurence V. Kanter trust was the income of Laurence V. Kanter as earned by the Kanter & Wolins Partnership and was properly taxed to the plaintiff rather than to the trust.

IV.

Laurence V. Kanter, beneficiary of the Laurence V. Kanter trust, had such control over the corpus of the trust as to make the income therefrom his own.

V.

The three trusts established by Minnie Kanter lacked substance and reality, had no business purpose, existed solely for the purpose of tax avoidance, and were not valid under the income tax laws.

VI.

Laurence V. Kanter was as much the owner of the income paid by the Kanter & Wolins Partnership to the Laurence V. Kanter trust as he was with respect to the income paid directly to him as a limited partner.

VII.

Defendant is entitled to judgment that the plaintiff take nothing by his complaint; that the action be dismissed with prejudice, and that it have its costs in its behalf incurred.

VIII.

All findings of fact which are or are deemed to be conclusions of law are hereby incorporated and concluded as conclusions of law.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, It Is Hereby Ordered, Adjudged and Decreed: [37]

That the plaintiff take nothing by his complaint, that the above-entitled action be dismissed with prejudice, and that the defendant have judgment for and recover from plaintiff the amount of defendant's costs, to be taxed by the Clerk of this Court in the sum of \$20. (8/2/57.) No obj.

Dated: This 26th day of July, 1957.

/s/ WM. C. MATHES,
United States District Judge.

Affidavit of Service by Mail attached.

Lodged July 17, 1957.

[Endorsed]: Filed July 26, 1957.

Entered July 29, 1957. [38]

[Title of District Court and Cause.]

NOTICE OF ENTRY OF JUDGMENT

To the Plaintiff, Laurence V. Kanter, and Adams, Duque & Hazeltine, and Burton & Zerwekh, by Bryant R. Burton, Esq., His Attorneys:

You, and Each of You, Will Please Take Notice that:

On July 29, 1957, Judgment was docketed and entered in the above-entitled case.

Dated: July 30, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant United States At-
torney, Chief, Tax Division;

/s/ EDWARD R. McHALE,
Attorneys for Defendant,
United States of America.

Affidavit of Service by Mail attached.

[Endorsed]: Filed July 30, 1957. [40]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO COURT
OF APPEALS UNDER RULE 73 (B)

Notice is hereby given that Laurence V. Kanter, plaintiff in the above-entitled action, hereby appeals to the Court of Appeals for the Ninth Circuit from the final judgment entered in said action on July 29, 1957, in favor of defendant and against the plaintiff.

Dated: September 18, 1957.

ADAMS, DUQUE &
HAZELTINE,

By /s/ BRYANT R. BURTON,
Attorneys for Plaintiff.

[Endorsed]: Filed September 19, 1957. [42]

PLAINTIFF'S EXHIBIT 1-A

Declaration of Trust

This Declaration of Trust entered into this 3rd day of March, 1944, by and between Minnie F. Kanter, as Trustor, and Albert L. Wolins and Ruth Wolins, herein designated as Trustees, all of the County of Los Angeles, State of California,

Witnesseth:

That Trustor has conveyed, transferred, assigned and delivered to the Trustees all that certain real and personal property described in Exhibit "A" (attached hereto and made a part hereof), which said property together with any other property which the Trustor or others may hereafter transfer or cause to be transferred to the Trustees to be held under this Trust is designated in this Declaration of Trust as the "Trust Estate."

That no consideration was or will be given by the Trustees for the transfer to them of any of the Trust Estate; that Trustees accept such title to the Trust Estate as is conveyed to them hereunder without liability or responsibility for the condition or validity of such title and the same has been and will be transferred to the Trustees, in trust, with power of sale, for the purpose of holding, managing, controlling and disposing of same and all income or other proceeds derived therefrom only in the manner and for the uses and purposes and upon the terms, trusts and conditions as hereinafter provided, namely:

First: Trustor cannot change, amend or revoke this Trust or any part hereof, or withdraw any of the property therefrom and has absolutely no control over the same whatsoever, except that Trustor may add additional property to said Trust Estate, which shall be subject to all the terms of this [43] Trust.

Second: The Trustees may hold, maintain or continue any securities, properties or investments received by it hereunder, whether or not the same be of the character permitted by law for investment of Trust Funds, or in their sole, absolute and uncontrolled discretion may grant, bargain, sell, convey, exchange, convert, lease for terms either within or beyond the duration of this Trust, grant for like terms the right to mine or drill for and remove therefrom, gas, oil and/or other minerals, assign, partition, divide, subdivide, improve, loan, reloan, invest and reinvest the Trust Estate in common stocks, preferred stocks, bonds, notes, real or personal property, or other securities and investments, whether or not permitted by law for the investment of Trust Funds, take and hold securities or other property in their own name or in the name of their nominee without disclosing any fiduciary relation, effect insurance, including public liability insurance, at the expense of the Trust Estate, of such nature and in such form and amounts as the Trustees deem advisable, borrow money for any Trust purpose, hypothecate the Trust Estate, or any part thereof, and/or replace, renew and/or

extend any encumbrance thereon, upon such terms and conditions and by such means of security as may be determined upon by the Trustees, including the conveyance of any real property or the assignment, transfer and/or delivery of any personal property, to such person as they shall select, for the purpose of executing and delivering the note, mortgage, deed of trust or other instrument to evidence or secure any such debt, and of reconveying or retransferring such property to the Trustees subject thereto, without causing any suspension or interruption of the Trusteeship hereunder, and generally in all respects manage the Trust Estate in such manner and upon such terms and conditions as to said Trustees, in their absolute and uncontrolled [44] discretion, may seem best, and may do all of such other things and exercise and execute each and every right, power and privilege in connection with or with relation to the Trust Estate, as could be done, exercised and/or executed by an individual holding and owning said property in absolute and unconditional ownership, including, without limiting the foregoing, the rights as respects stocks and bonds of voting, giving of proxies, payment of calls for assessments, exchanging securities, selling or exercising stock subscription or conversion rights, participating in foreclosures, reorganizations, consolidations, mergers, liquidations, pooling agreements or voting trusts and assenting to corporate sales or other acts. The Trustees are authorized to disclose the provisions of this Declaration of Trust

whenever, in their discretion, such disclosure will facilitate the operation of the Trust.

Third: For the purposes of this paragraph it is understood that the term of this Trust shall be 15 years and 10 months. Said term shall be divided into three periods.

a. "Period A" shall start March 3, 1944 and terminate on January 2, 1950.

b. "Period B" shall start on January 3, 1950, and terminate on January 2, 1955.

c. "Period C" shall start on January 3, 1955, and terminate on January 2, 1960.

After paying or reserving sufficient money to pay any expenses of management of the Trust Estate and administering this Trust, including the compensation for the services of the Trustees, all income from the Trust Estate during "Period A" shall be held in said Trust Estate as undistributed income and shall be available for distribution and shall be distributed to the beneficiary hereof on the 2nd day of January, 1950. All net income from the Trust [45] Estate during "Period B" shall be accumulated and distributed to the beneficiary hereinafter named on the 2nd day of January, 1955. All net income from the Trust Estate during "Period C" shall be accumulated as undistributed income in said Trust Estate and distributed to the beneficiary hereinafter named, together with all other income and principal of this Trust Estate, on the 2nd day of January, 1960.

Fourth: The beneficiary of this Trust shall be Laurence V. Kanter. Anything herein contained to the contrary notwithstanding, this Trust shall cease and terminate upon the 2nd day of January, 1960, or upon the death of the beneficiary, whichever date shall first occur. If, upon the 2nd day of January, 1960, the beneficiary hereof shall be alive, the principal and net accumulated income, shall be paid to Laurence V. Kanter, beneficiary herein. In the event that Laurence V. Kanter, the beneficiary herein dies prior to the 2nd day of January, 1960, leaving lawful issue or lawful spouse him surviving, then the principal and the accumulated income shall be distributed by the Trustees to said lawful issue and lawful spouse, share and share alike, at a time after said date of death as in the sole discretion of the Trustees shall be proper. In the event that the beneficiary herein shall die prior to the 2nd day of January, 1960, without leaving a lawful spouse or issue him surviving, then the principal and the accumulated income shall be distributed by the Trustees to Ruth Wolins and Jerome B. Kanter or to the survivor of them (secondary beneficiaries), share and share alike. In the event of such occurrence and if either of the "secondary beneficiaries" shall have predeceased the beneficiary hereof, leaving lawful spouse or issue surviving the said "secondary beneficiaries," the said lawful spouse or issue shall receive the share of the "secondary beneficiary," share and share alike. In the event that the beneficiary and both "secondary beneficiaries" [46] shall die prior to the 2nd day of January, 1960,

leaving no lawful spouse or issue surviving any of them, then upon the death of the beneficiary the principal and accumulated income shall be distributed to the heirs-at-law of the beneficiary, provided, however, that in no event shall any of the principal or income of this Trust Estate at any time or ever be distributor to the Trustor. Any distribution of principal hereunder to a minor may be made to the guardian of the estate of such minor.

Fifth: In the sole and exclusive discretion of the Trustees the accumulated income may be paid to the beneficiary at any other time or times than set forth herein if in their opinion the said beneficiary does not have sufficient income from other sources to provide for his proper support, maintenance, comfort, education and recreation.

Sixth: No interest of any beneficiary in this Trust, nor any part of such interest, shall in any event be subject to sale, assignment, hypothecation, or transfer by any beneficiary, nor shall the principal of the Trust Estate hereunder, or the income arising therefrom be liable for any debt of any beneficiary, or subject to any judgment rendered against any beneficiary, or to the process of any court in aid of execution of any judgment so rendered, and all of the income and/or principal under the Trust shall be transferable, payable and deliverable only to the beneficiaries designated hereunder at the times entitled to take same under the terms of this Trust, and the personal receipts of said designated beneficiaries shall be conditions precedent to

the payment or delivery of the same by said Trustees to such beneficiaries. This provision shall not restrict any authority of the Trustees to use and disburse funds for the maintenance and education of a beneficiary or to disburse funds to a guardian as herein provided.

Seventh: In the event the Trustees are required to [47] distribute any moneys hereunder to, or use, or expend such moneys for the benefit, support or maintenance of a minor, or an incompetent person, each such distribution or expenditure may, at the sole discretion of the Trustees, be made without the intervention of any court, or the Trustees may distribute to the guardian having the legal custody of such minor or incompetent and the voucher of such guardian shall be full acquittance to the Trustees for any sums so distributed; but the Trustees may, in their discretion, require such reports and take such steps as it may deem requisite to assure and enforce the due application of such money to the purposes aforesaid.

Eighth: If the whole or any part of the Trust Estate, or the proceeds or avails thereof, shall become liable for the payment of any tax, charge or assessment which said Trustees shall be required to pay, said Trustees shall have the full power and authority, without previous notice to or demand upon any person, to pay such tax, charge or assessment, any sums so paid which are a charge against any beneficiary hereunder shall be deducted from the interest of the beneficiary so liable. Estate and

inheritance taxes so paid by the Trustee shall be charged to principal. Other taxes shall be charged to income, provided, however, that any tax levied upon profit or gain which inures to the benefit of principal shall be paid out of principal, notwithstanding said tax may be denominated a tax upon income by the taxing authority. Improvement assessments shall be charged to principal and maintenance assessments shall be charged to income. The foregoing provisions shall not be construed as imposing upon this Trust Estate any liability for any such succession, inheritance or other death taxes or duties or as requiring it to contribute toward the payment thereof.

Ninth: The Trustees shall amortize premiums or accumulate discounts. All dividends accruing on corporate stock and [48] payable in the shares of the corporation itself, and all rights to subscribe to the shares or other securities or obligations of a corporation accruing on account of the ownership of stock in such corporation, and the proceeds of any sale of such rights, shall be deemed principal. All dividends payable otherwise than in the shares of the corporation itself shall be deemed income, except that amounts paid on corporate stock upon liquidation of the assets of the corporation as a return of the original investment and such part of dividends as is designated by the corporation as a return of capital or distribution of assets shall be deemed principal. Where the Trustees shall have the option of receiving a dividend either in cash or in

the shares of the declaring corporation, it shall be considered a cash dividend irrespective of the choice made by the Trustees. Unless otherwise specifically provided in this Declaration of Trust, the Trustees shall have absolute discretion in determining what is principal or income and what shall be charged or credited to either, and their judgment shall bind everyone beneficially interested hereunder. The Trustees may rely upon the statement of the paying corporation as to whether dividends are paid from profits or earnings or are a return of capital or a distribution of assets, and as to any other fact relevant hereunder, concerning the source or character of dividends or distributions of corporate assets.

Tenth: Any instrument properly executed hereunder by the Trustees, and the contents thereof, shall be binding on all parties hereto and all beneficiaries hereunder. No person paying money to the Trustees need see to the application of the money so paid.

Eleventh: Upon any division or distribution of the Trust Estate, in whole or in part, the Trustees may assign, transfer or deliver to the person, share or department, then entitled thereto, [49] any part of the Trust Estate or an undivided interest in the Trust Estate, or any portion thereof, at such valuation as the Trustees may establish as the then fair market value, or may, within a reasonable time, convert the Trust Estate, or any portion thereof, into cash, distributing the net proceeds to such person,

share or department, all in the absolute discretion of the Trustees.

Twelfth: The Trustees herein shall be joint Trustees and their joint signatures shall be required for the performance of any acts hereunder. In the event any one Trustee refuses to act or for any other reason cannot act, then the remaining Trustee shall act alone. In the event that both Trustees cannot, or will not act, then Bank of America, National Trust & Savings Association shall be appointed as Trustee and shall succeed to all the rights, powers, duties and obligations herein imposed. The resigning Trustee or Trustees shall transfer to the successor hereunder the entire estate then remaining in this Trust.

Thirteenth: From the income and/or principal of the Trust Estate the Trustees shall pay and discharge all expenses incurred in the administration of this Trust and protection of this Trust against legal or equitable attack, including attorney's fees and reasonable compensation for their services as Trustees, which compensation is agreed to be as follows:

An annual fee equal to 2% of the annual income of this Trust.

All expenses such as costs of preparation and filing of tax returns, furnishing of statements and such other services not expressly provided for shall be paid for from the income of this Trust. [50]

In witness whereof the Trustees have caused their hands to be affixed hereto this 3rd day of March, 1944.

/s/ ALBERT L. WOLINS,
Trustee.

/s/ RUTH WOLINS,
Trustee.

The undersigned Trustor does hereby certify that she has read the foregoing Declaration of Trust and that the same fully and accurately sets out the terms, trusts and conditions under which the Trust Estate therein described is to be held, managed and disposed of by the Trustees therein named and does hereby approve, ratify and confirm the said Declaration of Trust in all particulars.

Dated March 3, 1944.

/s/ MINNIE F. KANTER.

State of California,
County of Los Angeles—ss.

On this 3rd day of March, 1944, before me Max Feingold, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared Minnie F. Kanter, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me she executed the same.

In witness whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

/s/ MAX FEINGOLD,

Notary Public in and for Said
County and State. [51]

Exhibit "A"

One Hundred Fifty (150) shares of the Common Stock of Shop 'N Save, a California corporation.

* * *

The above shares were cancelled and delivered up in return for a 6.81% undivided interest as a limited partner in Kanter & Wolins, a limited partnership.

Admitted in evidence March 4, 1957.

PLAINTIFF'S EXHIBIT I-D

Certificate of Limited Partnership

This Certificate of Limited Partnership is entered into in duplicate and is executed in accordance with the provisions of the Civil Code of the State of California, Sections 2477 to 2510, inclusive.

One: The name of the Limited Partnership shall be Kanter & Wolins.

Two: The character of the business of this Limited Partnership shall be the conducting of retail food markets.

Three: The principal place of business of this Limited Partnership shall be 4756 Whittier Boulevard, Los Angeles, California, and such other place or places as the general partners may from time to time determine.

Four: The names and residences of each of the members of this Limited Partnership are as follows:

Harry L. Kanter, general partner, 10100 Sunset Boulevard, Los Angeles, California;

Laurence V. Kanter, general partner, 10100 Sunset Boulevard, Los Angeles, California;

Albert L. Wolins, general partner, 10100 Sunset Boulevard, Los Angeles, California;

Minnie F. Kanter, limited partner, 10100 Sunset Boulevard, Los Angeles, California;

Jerome B. Kanter, limited partner, 10100 Sunset Boulevard, Los Angeles, California;

Ruth Wolins, limited partner, 10100 Sunset Boulevard, Los Angeles, California;

Albert L. Wolins, Trustee for Sue Ellen Wolins, limited partner, 10100 Sunset Boulevard, Los Angeles, California, Trust No. 4;

Ruth Wolins and Laurence V. Kanter, Trustees for Jerome B. Kanter, limited partner, Trust No. 1, 10100 Sunset Boulevard, Los Angeles, California; [53]

Albert L. Wolins, Ruth Wolins, Trustees for Laurence V. Kanter, limited partner, Trust No. 2, 10100 Sunset Boulevard, Los Angeles, California;

Albert L. Wolins and Laurence V. Kanter, Trustees for Ruth Wolins, limited partner, Trust No. 3, 10100 Sunset Boulevard, Los Angeles.

Five: This partnership shall exist for a period of ten years and may be renewed from time to time thereafter by the written consent of the partners.

Six: The limited partners shall contribute cash and/or fixtures and/or equipment and/or merchandise and/or real property and improvements thereon and such other real or personal property which has already been evaluated and in the amounts set opposite their names.

Minnie F. Kanter.....	\$105,894.00
Jerome B. Kanter.....	15,000.00
Ruth Wolins	5,300.00
Trust No. 1.....	15,900.00
Trust No. 2.....	15,900.00
Trust No. 3.....	15,900.00
Trust No. 4.....	1,060.00

Seven: It is agreed that a limited partner's contribution shall be returned upon the dissolution of this partnership or upon a six months' written notice at any time prior thereto.

Eight: The following partners shall be paid the following sums of money annually for their services

on behalf of the partnership, which sums, for the purpose of determining profits to be distributed to the partners, shall be deemed an expense of doing business, to-wit:

Harry L. Kanter.....	\$20,000.00
Laurence V. Kanter.....	8,000.00
Jerome B. Kanter.....	4,000.00
Albert L. Wolins.....	20,000.00

Nine: All profits remaining in the partnership after the payment of the salaries set up in Paragraph Eight shall be [54] distributed at the end of each fiscal year to the partners (general and limited) in proportion to their capital investment in this partnership.

Ten: No limited partner may substitute an assignee as a contributor in his place and stead in this partnership. No additional partners, either limited or general, may be admitted to this partnership.

Eleven: In the event of dissolution of this limited partnership, the limited partners shall receive their full contribution plus increases thereon before the general partners shall receive part of their contributions herein. In the event of any loss exceeding the investment of the general partners herein, the limited partners shall share the remaining loss pro-rata up to the aggregate of their respective contributions as limited partners. No limited partner shall be required to share in the losses of this limited partnership in any amount to ex-

ceed in the aggregate the amount of his or her respective contributions.

Twelve: This partnership shall terminate immediately upon the death, retirement, incompetency or insanity of any general partner.

Thirteen: The terms of the agreement of limited partnership entered into contemporaneously herewith are binding upon the parties hereto.

Dated this 31st day of March, 1944.

/s/ HARRY L. KANTER,

/s/ LAURENCE V. KANTER,

/s/ ALBERT L. WOLINS,

/s/ MINNIE F. KANTER,

/s/ JEROME B. KANTER,

/s/ RUTH WOLINS,

/s/ ALBERT L. WOLINS,

Albert L. Wolins, Trustee for Sue Ellen Wolins,
Trust No. 4.

/s/ RUTH WOLINS,

/s/ LAURENCE V. KANTER,

Ruth Wolins and Laurence V. Kanter, Trustees
for Jerome B. Kanter, Trust No. 1.

/s/ ALBERT L. WOLINS,

/s/ RUTH WOLINS,

Albert L. Wolins and Ruth Wolins, Trustees for
Laurence V. Kanter, Trust No. 2.

/s/ ALBERT L. WOLINS,

/s/ LAURENCE V. KANTER,

Albert L. Wolins and Laurence V. Kanter, Trustees for Ruth Wolins, Trust No. 3.

State of California,

County of Los Angeles—ss.

Before me, Max Feingold, Notary Public in and for the County of Los Angeles, State of California, on the 31st day of March, 1944, personally appeared the above-named persons, who, in their own and in their representative capacities acknowledged the above Certificate of Limited Partnership and who stated to me that they were signing and executing the said Certificate of Limited Partnership in compliance with the Civil Code of the State of California, relating thereto and who further swear that the contents of said Certificate of Limited Partnership are true and correct, except where the same is alleged on information and belief.

/s/ MAX FEINGOLD,

Notary Public in and for the County of Los Angeles, State of California.

Admitted in evidence March 4, 1957. [56]

EXHIBIT I-E

Agreement of Limited Partnership

This Agreement of Limited Partnership entered into this 31st day of March, 1944, by and between Harry L. Kanter, Laurence V. Kanter, Albert L. Wolins, Minnie F. Kanter, Jerome B. Kanter, Ruth Wolins, Albert L. Wolins, Trustee for SueEllen Wolins, Trust No. 4, Ruth Wolins and Laurence V. Kanter, Trustees for Jerome B. Kanter, Trust No. 1, Albert L. Wolins and Ruth Wolins, Trustees for Laurence V. Kanter, Trust No. 2, and Albert L. Wolins and Laurence V. Kanter, Trustees for Ruth Wolins, Trust No. 3, all of the County of Los Angeles, State of California,

Witnesseth:

One: The parties do hereby form each with the other a limited partnership under the Uniform Limited Partnership Act of the State of California contained in Sections 2477 to 2510, inclusive, of the Civil Code of the State of California, to carry on the business of retail food and liquor markets at the following addresses, among others:

3250 Glendale Boulevard, Los Angeles, California,

4756 Whittier Boulevard, Los Angeles, California,

2047 Del Mar Avenue, Wilmar, California,

1558 Valley Boulevard, Rosemead, California,

706 Las Tunas Drive, San Gabriel, California,

208 East Valley Boulevard, Alhambra, California,

2532 West Valley Boulevard, Alhambra, California,

420 West Main Street, El Monte, California,

108 Pamona Boulevard, Baldwin Park, California,

or such other places as the general partners may from time to time designate.

Two: This limited partnership shall be known as Kanter & Wolins.

Three: The general partners shall be the following persons who shall contribute as a general investment the sums set opposite their names: [57]

Harry L. Kanter, 10100 Sunset Boulevard, Los Angeles, California...\$31,058.00

Laurence V. Kanter, 10100 Sunset Boulevard, Los Angeles, California 15,900.00

Albert L. Wolins, 10100 Sunset Boulevard, Los Angeles, California.. 10,600.00

It is understood that said investments may be contributed in cash or in property. If in property, said property shall be evaluated as of the present fair market value. The general partners shall be entitled to share in the profits and losses of this partnership in the proportions set opposite their names.

Harry L. Kanter.....	13.31%
Laurence V. Kanter.....	6.81%
Albert L. Wolins.....	4.54%

But if the limited partners' contributions shall have been exhausted by the applications of losses, the general partners shall each be jointly and severally liable for losses occurring thereafter in the proportions that their capital investments shall bear to each other.

Four: The limited partners shall be the following, whose limited contributions are set opposite their names.

Minnie F. Kanter, 10100 Sunset Boulevard, Los Angeles, California	\$105,894.00
Jerome B. Kanter, 10100 Sunset Boulevard, Los Angeles, California	15,900.00
Ruth Wolins, 10100 Sunset Boule- vard, Los Angeles, California....	5,300.00
Ruth Wolins and Laurence V. Kan- ter, Trustees for Jerome B. Kan- ter, Trust No. 1, 10100 Sunset Boulevard, Los Angeles, Cali- fornia	15,900.00
Albert L. Wolins and Ruth Wolins, Trustees for Laurence V. Kanter, Trust No. 2, 10100 Sunset Boule- vard, Los Angeles, California....	15,900.00

Albert L. Wolins and Laurence V. Kanter, Trustees for Ruth Wolins, Trust No. 3, 10100 Sunset Boule- vard, Los Angeles, California....	15,900.00
Albert L. Wolins, Trustee for Sue- Ellen Wolins, 10100 Sunset Boule- vard, Los Angeles, California....	1,060.00

Each limited partner may contribute his or her investment in the form of cash or property. If in property, said property shall be evaluated at the present fair market value. All limited partners shall share in the profits and losses of this limited partnership in the proportions set opposite their respective names.

Minnie F. Kanter.....	45.37%
Jerome B. Kanter.....	6.81%
Ruth Wolins	2.27%
Albert L. Wolins, Trustee for Sue- Ellen Wolins, Trust No. 4.....	.46%
Ruth Wolins and Laurence V. Kanter, Trustees for Jerome B. Kanter, Trust No. 1	6.81%
Albert L. Wolins and Ruth Wolins, Trustees for Laurence V. Kanter, Trust No. 2.....	6.81%
Albert L. Wolins and Laurence V. Kan- ter, Trustees for Ruth Wolins, Trust No. 3	6.81%

but the share of any limited partner in the losses shall not, in any event, exceed in the aggregate the amount of his or her respective contributions.

Six: The term for which this limited partnership shall exist is the period from 12:01 o'clock a.m. Saturday, April 1, 1944, until midnight, March 31, 1954, and thereafter in five-year periods during the mutual agreement of the general partners.

Seven: The contribution of each limited partner increased by gains credited but not withdrawn, or decreased by losses [59] as determined under Paragraph Five hereof is to be returned upon the termination of the limited partnership in accordance with the terms of Paragraph Five hereof or upon any earlier dissolution of this limited partnership caused by the death, retirement, insanity or incompetency of a general partner, provided that at such time all liabilities of the partnership except liabilities to general partners and to limited partners on account of their contributions shall have been paid and that there shall then be real property of the partnership sufficient to make such return to the limited partners. If the property thus remaining shall not be sufficient to repay in full all of the partners, general and limited, their contributions adjusted to reflect accumulated gains or losses as above provided, then each of the partners shall receive his or her respective contribution adjusted as provided in the Certificate of Limited Partnership recorded and filed as required by the statutes. In the event that the limited partners shall receive less than their adjusted partnership contributions, they shall have no further claim against the general partners for the return of the remaining balance of their contributions or credited gains.

Eight: The interest of the limited partners herein shall not be assignable but the legal representative of any deceased limited partner may have the rights and duties conferred upon him by the death of a limited partner as provided in the laws of the State of California appertaining thereto.

Nine: True, just and correct books of account shall be kept in which there shall be entered all of the transactions of or relating to the partnership or to business.

Ten: The general partners shall be co-managers of the business of this limited partnership. For their services on behalf [60] of this limited partnership they shall receive the following annual salaries paid in such installments and at such times as they deem proper:

Harry L. Kanter.....	\$20,000.00
Laurence V. Kanter.....	8,000.00
Albert L. Wolins.....	20,000.00

These salaries are to be treated as an expense of the business in the ascertainment of profits for distribution among the partners and said parties agree to devote their entire time, skill and effort to their duties as co-managers of this partnership except for such period as they or any of them may be prevented by illness or other emergencies or as the general partners may agree upon. The general partners agree that they will not, directly or indirectly, use the partnership name except for the legitimate pur-

poses of the partnership without the express permission of the other general partners in writing first had and obtained. It is understood and agreed that Jerome B. Kanter, a limited partner herein, is presently a member of the armed forces of the United States and shall receive as additional compensation (to be classed as an expense of business for these purposes) the sum of \$4,000.00 per year while in the armed forces.

Eleven: In the event of the death, retirement, insanity or incompetency of any of the general partners during the continuance of this agreement or any renewal or extension thereof, an accounting shall forthwith be taken of the assets and liabilities of the partnership as of the last day of the calendar month preceding the death of said general partner. For the purpose of determining the book value of the general partner's interest, good will shall not be used as an asset. The surviving general [61] partners within sixty (60) days after date of death, retirement, insanity or incompetency of any other general partner shall notify the legal representative of such partner of his or their intention to purchase the aforesaid general partner's interest determined as above outlined. Within one hundred eighty (180) days after date of death, retirement, insanity or incompetency the surviving general partners or any of them who exercise the above option shall pay to the legal representative of the aforesaid general partner the value of the interest of said general partner in this partnership. In the event that none

of the surviving general partners desire to purchase the said interests, the assets of the partnership shall be liquidated at either public or private sale under the supervision of the surviving general partners and the legal representatives of the other general partners and all funds realized by such sale shall be distributed in accordance with the laws of the State of California pertaining thereto.

Twelve: The general partners shall start such bank accounts in such banks as they deem necessary and proper. All checks, drafts, notes and other evidences of indebtedness may be signed by any one of the general partners.

Thirteen: This Agreement shall be binding upon the heirs, administrators, legal representatives and assigns of each of the parties hereto.

In witness whereof, the parties hereto have hereunto set their hands this day and year first above written.

/s/ HARRY L. KANTER,
General Partner.

/s/ LAURENCE V. KANTER,
General Partner. [62]

/s/ ALBERT L. WOLINS,
General Partner.

/s/ MINNIE F. KANTER,
Limited Partner.

/s/ JEROME B. KANTER,
Limited Partner.

/s/ RUTH WOLINS,
Limited Partner.

/s/ RUTH WOLINS,
/s/ LAURENCE V. KANTER,
Ruth Wolins & Laurence V. Kanter, Trustees for
Jerome B. Kanter, Limited Partner, Trust
No. 1.

/s/ ALBERT L. WOLINS,
/s/ RUTH WOLINS,
Albert L. Wolins & Ruth Wolins, Trustees for
Laurence V. Kanter, limited partner, Trust
No. 2.

/s/ ALBERT L. WOLINS,
/s/ LAURENCE V. KANTER,
Albert L. Wolins & Laurence V. Kanter, Trustees
for Ruth Wolins, Limited Partner, Trust No. 3.

/s/ ALBERT L. WOLINS,
Albert L. Wolins, Trustee for SueEllen Wolins,
Limited Partner, Trust No. 4

Admitted in evidence March 4, 1957. [63]

DEFENDANT'S EXHIBIT A

United States District Court for the Southern
District of California, Central Division

No. 15350-WM Civil

LAURENCE V. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15399-WM Civil

RUTH WOLINS,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15534-WM Civil

JEROME B. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

SUPPLEMENTAL STIPULATION OF FACTS

It is hereby further stipulated, in addition to
the facts stipulated in that Stipulation of Facts

filed on February 4, 1957, by and between the parties hereto through their respective counsel, without prejudice to their right to object to the materiality or relevancy of any of the facts agreed to, as follows: [64]

XI.

Minnie Kanter during the early part of 1944 desired to make a gift of a portion of her interest in Shop 'N Save to her three children. Her sole purpose in executing these trusts, rather than in making outright gifts of property to her children, was to reduce the taxes that her children would have to pay on the income from the property gifted by her.

XII.

At the time of execution of these trusts and during the years before this Court the income tax on income from the property gifted by Minnie Kanter would have been taxed at a higher tax rate if distributed directly to Laurence Kanter, Jerome Kanter, and Ruth Wolins than if taxed at the rates imposed against trusts.

XIII.

The dissolution of Shop 'N Save and the organization of a limited partnership under the name of Kanter and Wolins was within the contemplation of the shareholders of Shop 'N Save prior to the execution of these trusts by Minnie Kanter. Since the inception of the trusts and to date, the corpus of the trusts has consisted solely of the limited partnership interests herein described.

Dated: February 11, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Asst. U. S. Attorney, Chief,
Tax Division;

SIDNEY J. MACHTINGER,
Special Attorney, Internal
Revenue Service;

/s/ EDWARD R. McHALE,
Attorneys for Defendant.

ADAMS, DUQUE &
HAZELTINE,

/s/ BRYANT R. BURTON,
Attorneys for Plaintiff.

Admitted in evidence March 4, 1957. [65]

DEFENDANT'S EXHIBIT B

United States District Court for the Southern Dis-
trict of California, Central Division

No. 15350-WM Civil

LAURENCE V. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15399-WM Civil

RUTH WOLINS,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

No. 15534-WM Civil

JEROME B. KANTER,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

SECOND SUPPLEMENTAL
STIPULATION OF FACT

It Is Hereby Further Stipulated and Agreed
by and between the parties hereto through their

respective counsel of record, that the following facts are true; provided, however, that plaintiffs object to the materiality and relevancy of said facts. [66]

XIV.

From the inception of the partnership business of Kanter & Wolins on April 1, 1944, the value of the corpus of each trust was credited to the capital account of each trust on the books of the Kanter & Wolins partnership. No separate books were ever kept for the trusts. All transactions affecting the trusts were reflected in the capital accounts of the trusts as limited partners on the books of the partnership.

XV.

The original value of the corpus of each trust as of March 3, 1944 was \$15,900.00. Between April 1, 1944 and January 2, 1950, the limited partnership income of each of the trusts was credited by the Kanter & Wolins partnership to each trust as follows:

March 31, 1945	\$2,075.39
March 31, 1946	6,881.59
March 31, 1947	8,107.78
March 31, 1948	7,622.31
March 31, 1949	9,514.48

As of January 2, 1950, the capital account of each trust as reflected on the books of Kanter & Wolins after deducting expenses of administering each trust was as follows:

Jerome B. Kanter, Trust No. 1	\$45,100.57
Laurence V. Kanter, Trust No. 2	43,958.11
Ruth Wolins, Trust No. 3	43,729.66

XVI.

On January 9, 1950, the Kanter & Wolins partnership exchanged substantially all of its assets for all of the common stock in the newly formed McDaniel's Market, a corporation. The total capital of McDaniel's Markets per its books was \$416,810.00, representing the value of the assets of the Kanter & Wolins partnership transferred to the corporation.

On May 31, 1950, the partnership books were posted to show the investment of \$416,810.78 of partnership net worth in the common stock of the corporation which reflected the following investment by the trusts [67] in said common stock:

Jerome B. Kanter, Trust No. 1	\$42,456.11
Laurence V. Kanter, Trust No. 2	41,313.65
Ruth Wolins, Trust No. 3	41,085.20

This left the following balances in said limited partners' accounts invested in the remaining assets of the partnership:

Jerome B. Kanter, Trust No. 1	\$3,364.56
Laurence V. Kanter, Trust No. 2	3,364.56
Ruth Wolins, Trust No. 3	3,364.56

XVII.

Between January 10, 1950 and January 10, 1956, McDaniel's Markets incurred a total operating deficit of \$247,619.93, which arose as follows:

Net loss fiscal year, 1951	(\$ 23,921.08)
Net loss fiscal year, 1952	(194,707.19)
Net profit fiscal year, 1953	36,990.24
Net profit fiscal year, 1954	95,503.62
Net loss fiscal year, 1955	(76,506.89)
Net loss fiscal year, 1956	(84,978.23)

Deficit in surplus account

as of May 31, 1956 (\$247,619.93)

XVIII.

Between January 3, 1950 and January 2, 1955, the limited partnership income or loss for each of the trusts was credited by the Kanter & Wolins partnership to the trusts as follows:

March 31, 1950.....	(\$2,569.82)
March 31, 1951.....	1,210.25
March 31, 1952.....	21.78
March 31, 1953.....	(136.19)
March 31, 1954.....	207.58

As of January 2, 1955, the capital account of each trust as reflected on the books of the Kanter & Wolins partnership after deducting expenses of [68] administering each trust was as follows:

Jerome B. Kanter, Trust No. 1.....	\$47,198.73
Laurence V. Kanter, Trust No. 2....	46,056.27
Ruth Wolins, Trust No. 3.....	45,827.82

XIX.

Since the inception of the trusts, their income as limited partners in the Kanter & Wolins partner-

ship was credited to the capital accounts of the trusts and retained in the partnership.

XX.

No dividends on the common stock have been declared by McDaniel's Markets since its inception.

XXI.

The Kanter & Wolins partnership continues to hold all the common stock. Preferred stock was issued by the corporation in order to obtain outside capital and at various dates the following amounts of preferred stock were outstanding:

May 31, 1951	\$125,000
May 31, 1952	180,200
May 31, 1953	181,275
May 31, 1954	181,275
May 31, 1955	181,275
May 31, 1956	240,225

Preferred stock dividends were paid as follows for the years ending May 31:

May 31, 1951	\$ 6,250.00
May 31, 1952	7,856.96
May 31, 1953	10,876.50
May 31, 1954	10,876.50
May 31, 1955	10,876.50

Dated: This 28th day of February, 1957.

LAUGHLIN E. WATERS,
United States Attorney,

EDWARD R. McHALE,
Asst. United States Attorney,

By /s/ EDWARD R. McHALE,
Attorneys for Defendant.

ADAMS, DUQUE &
HAZELTINE,

By /s/ BRYANT R. BURTON,
Attorneys for Plaintiff.

Admitted in evidence March 4, 1957. [69]

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled cases:

A. The foregoing pages numbered 1 to 48, inclusive in Case No. 15350-WM, containing the original:

Complaint.

Answer.

Stipulation of Fact.

Order for Findings of Fact, Conclusions of Law and Judgment.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Entry of Judgment.

Notice of Appeal.

Appellee's Additional Designation of Contents of Record on Appeal.

Designation of Contents of Record on Appeal.

and, Pages numbered 49 to 82, inclusive, in Case No. 15399-WM, containing the original:

Complaint.

Answer.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Entry of Judgment.

Notice of Appeal.

Designation of Contents of Record on Appeal.

and, Pages numbered 83 to 116, inclusive, in Case No. 15534-WM, containing the original:

Complaint.

Answer.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Entry of Judgment.

Notice of Appeal.

Designation of Contents of Record on Appeal. [70]

B. Plaintiff's Exhibits 1-A, 1-B, 1-C, 1-D, 1-E.
Defendant's Exhibits A and B.

I further certify that my fee for preparing the foregoing record, amounting to \$2.00, has been paid by appellants.

Witness my hand and the seal of said District Court, this 17th day of October, 1957.

[Seal] JOHN A. CHILDRESS,
Clerk.

By /s/ WM. A. WHITE,
Deputy Clerk. [71]

[Endorsed]: No. 15757. United States Court of Appeals for the Ninth Circuit. Laurence V. Kanter, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed October 17, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15757

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT BY APPELLANT OF POINTS
ON WHICH HE INTENDS TO RELY ON
APPEAL

Laurence V. Kanter, appellant herein, by his attorneys, hereby states that he intends to rely upon the following points in this proceeding:

That the District Court erred:

(1) In admitting into evidence defendant's Exhibit "B" over plaintiff's objection directed to the materiality and relevancy thereof, in that the facts contained in said Exhibit "B" pertain principally to years other than the taxable years in question;

(2) In finding (in its Finding of Fact No. XXVI) that the beneficiaries of the trusts had unlimited power and control over the corpus of the trust in that said Finding of Fact is contrary to law, is not supported by any substantial evidence in the record and is not inferable from the reasons so stated in support of said Finding;

(3) In failing to find as a fact that there was no evidence that the beneficiaries of the trusts had

any express power over the corpus or income of the trusts;

(4) In failing to find as a fact that there was no evidence that the beneficiaries of the trusts had exercised any control over the corpus or income of the trusts;

(5) In concluding (in its Conclusion of Law No. II) that the plaintiff has failed to sustain his burden of proof that he has overpaid his income taxes for the years 1945, 1946 and 1947, in that said Conclusion of Law is contrary to law, contrary to the evidence and inconsistent with the District Court's Findings of Fact numbered XI, XII, and XVII;

(6) In concluding (in its Conclusion of Law No. III) that the undistributed income of the Laurence V. Kanter trust was the income of Laurence V. Kanter as earned by the Kanter and Wolins partnership and was properly taxed to the plaintiff rather than to the trust in that said Conclusion of Law is contrary to law, contrary to the evidence and inconsistent with the District Court's Findings of Fact numbered XI and XII;

(7) In concluding (in its Conclusion of Law No. IV) that Laurence V. Kanter, beneficiary of the Laurence V. Kanter trust, had such control over the corpus of the trust as to make the income therefrom his own in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record;

(8) In concluding (in its Conclusion of Law No. V) that the three (3) trusts established by Minnie

Kanter lacked substance and reality and were not valid under the income tax laws in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record;

(9) In concluding (in its Conclusion of Law No. VI) that Laurence V. Kanter was as much the owner of the income paid by the Kanter and Wolins partnership to the Laurence V. Kanter trust as he was with respect to the income paid directly to him as a limited partner in that said Conclusion of Law is contrary to law and is not supported by any evidence in the record;

(10) In failing to conclude as a matter of law that the undistributed income of the Laurence V. Kanter trust was the income of the trust and not the income of Laurence V. Kanter as a beneficiary thereof;

(11) In failing to conclude as a matter of law that plaintiff has overpaid his income taxes for the years 1945, 1946, and 1947, and is entitled to recover from the defendant the sum of Eight Thousand Six Hundred Fifty Dollars and Thirty-three Cents (\$8,650.33), together with interest thereon as provided by law.

Dated: October 9, 1957.

ADAMS, DUQUE &
HAZELTINE,

By /s/ BRYANT R. BURTON,
Attorneys for Appellant.

[Endorsed]: Filed October 22, 1957.

In the United States Court of Appeals
for the Ninth Circuit

No. 15757

LAURENCE V. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

RUTH WOLINS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

JEROME B. KANTER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STIPULATION RE DESIGNATION, PRINT-
ING AND USE OF RECORD

It is hereby stipulated by and between counsel
for the respective parties hereto as follows:

(1) The entire records in the cases of Laurence
V. Kanter vs. United States of America, Ruth Wo-
lins vs. United States of America, and Jerome B.
Kanter vs. United States of America as certified to
this Court by the Clerk of the United States District

Court for the Southern District of California, Central Division, are material to the consideration of the appeal.

(2) The following portions of the individual records as certified shall be included in the printed record:

(a) Complaint of Laurence V. Kanter vs. United States of America (No. 15350-WM Civil in the United States District Court) filed on April 3, 1953, including the exhibit attached thereto—(Page 2 of Certified Record).

(b) Answer in said action filed on March 16, 1955—(Page 10 of Certified Record).

(c) Stipulation of Facts filed in said action on or about February 1, 1957—(Page 15 of Certified Record).

(d) Plaintiff's Exhibits 1-A, 1-B, 1-C, 1-D and 1-E, received into evidence as per Minutes of Court dated March 4, 1957—(Exhibits 1-A, 1-B and 1-C are the trust instruments involved in these proceedings; 1-D is the Certificate of Limited Partnership, and 1-E is the Limited Partnership Agreement).

(e) Defendant's Exhibits A and B, received into evidence as per Minutes of Court of March 4, 1957—(Exhibit A is a Supplemental Stipulation of Facts and Exhibit B is a Second Supplemental Stipulation of Facts).

(f) Order for Findings of Fact, Conclusions of Law and Judgment—(Page 23 of Certified Record).

(g) Findings of Fact, Conclusions of Law and Judgment—(Page 25 of Certified Record).

(h) Judgment entered in said action on July 29, 1957—(Page 40 of Certified Record).

(i) Notice of Appeal in said action filed on September 19, 1957—(Page 42 of Certified Record).

(j) Statement by Appellant of Points on Which He intends to Rely on Appeal—(Not included in Certified Record; filed directly in Court of Appeals).

(k) This Stipulation re Designation, Printing and Use of Record.

(3) All portions of the records as certified by the Clerk of the United States District Court for the Southern District of California, Central Division, which are not included in the printed record, as indicated above, may be referred to by either party in briefs or arguments, the same as if said portions had been part of the printed record.

(4) The record as designated herein concerning the case of Laurence V. Kanter v. United States of America (No. 15350-WM Civil in the United States District Court) may be used in the following companion cases with the same force and effect and to all intents and purposes as though a duplicate of said record had been designated, printed, served and filed in each of said companion cases:

(1) Ruth Wolins v. United States of America (No. 15399-WM Civil in the United States District Court).

(2) Jerome B. Kanter v. United States of America (No. 15534-WM Civil in the United States District Court).

Dated: October 18, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant United States At-
torney, Chief, Tax Division.

By /s/ EDWARD R. McHALE,
Attorneys for Defendant.

ADAMS, DUQUE & HAZEL-
TINE,
BRYANT R. BURTON,

By /s/ BRYANT R. BURTON,
Attorneys for Appellants.

Ordered: Record in Case No. 15757 only be printed; records in Cases No. 15758 and 15759 to be referred to by the parties in their briefs and single briefs to be filed covering all three cases.

/s/ ALBERT LEE STEPHENS,
Chief Judge, U. S. Ct. of Appeals for the Ninth
Circuit.

[Endorsed]: Filed October 22, 1957.

